DOMESTIC ~~INTERSECTORAL~~ TERMS OF TRADE AND AGRICULTURAL ~~TAX~~ TAXATION POLICY IN PAKISTAN 1970-1977

SHAHNAZ KAZI

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School of Oriental and African Studies

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ProQuest LLC.
789 East Eisenhower Parkway
P.O. Box 1346
Ann Arbor, MI 48106 – 1346

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ABSTRACT: INTERSECTORAL TERMS OF TRADE AND AGRICULTURAL TAX POLICY IN PAKISTAN

The study has two major objectives. Firstly it attempts to assess the direction of intersectoral resource flows in the Pakistan economy through the mechanisms of terms of trade and tax policy. Towards this objective empirical estimates of sectoral terms of trade and tax burdens are provided for the period from 1970/71 to 1977/78. The second main aim of this research is to interpret changes in the price and tax policies over the period in the context of a political economy framework. This part of the discussion deals with the relative political strength of the leading classes and their influence on government decision making, specially with respect to prices and taxation. The study also briefly examines the implications of the policies pursued by the Bhutto government on the level of output, savings and distribution in the economy.

The findings of the research indicate that during the period under study no serious attempt was made to appropriate an investible surplus from agriculture either through price shifts or through the revenue system. The series of agriculture's net barter terms of trade revealed a consistently positive trend during the seventies while the tax burden on the high income groups in the rural sector was totally inadequate in terms of both equity and developmental objectives.

The study further links the failure to extract a surplus from the agricultural sector to the political dominance of the class of large landowners. The power of the landed elite is signed out as one of the principal reasons for the reluctance to reform the agrarian tax structure as well as for the policy of maintaining favourable relative prices of farm products.

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INTRODUCTION

Historically the process of capital formation and industrial development has been based on the extraction of a surplus from the agricultural sector. Intersectoral relationships during the initial phases of development of European countries and more recently Japan are well documented.[1] The literature shows that in each case the generation of an investible surplus in agriculture and its transfer to industry and other expanding sectors was a necessary condition for successful industrialisation.

Agriculture contributed to industry in the early phases of development by providing a flow of real and financial resources, both of which were vital to the process of structural change in the economy. The real surplus of agricultural products provided food, the major wage good of industrial labour, and raw materials for agrobased industry. The other aspect of the surplus was a flow of financial resources in the form of private savings, rent interest and taxes as well as the invisible transfer of funds through shifts in terms of trade.

Manipulation of terms of trade was a major device used for extracting the surplus from the farm sector. A cheapening of

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[1] E.g. Okhawa and Rosovsky (1960); Johnston and Mellor (1961); Nicholls (1964); Johnston and Kilby (1967).

agricultural products relative to non-farm products forced involuntary savings on the farm sector while diverting income to the non-agricultural sector. A negative price policy was instrumental in the transfer of real and financial resources to the industrial sector in the early development of a number of socialist and capitalist countries although it was implemented by different means. In Russia[1] it involved the collectivization of farms and compulsory delivery of agricultural output at very low prices, while in England the repeal of corn laws was aimed at keeping down the price of food and raw materials.[2] The other important mechanism for generating and diverting savings from agriculture into the investing sector was land taxation which was used most effectively in Meiji Japan.[3]

Development literature on intersectoral relationships has been greatly influenced by the economic history of the USSR and Japan. According to the traditional view[4] of Soviet development the extraction of a surplus from the agricultural sector was a major factor in making possible the rapid industrial expansion during the First Plan period from 1928-32. Collectivization of agriculture and maintaining terms of trade favourable to industry were the major policy variables employed by the state to enable a significant transfer of resources from the farm to the non-farm sector. The surplus out of agriculture was enlarged not through the attainment of a higher level of output, the measures did not succeed in raising agricultural productivity, but rather through the extraction of a greater proportion out of existing production levels.

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1 Erlich (1960), pp. 119-22; Nove (1969), pp. 148-86.

2 Chambers and Mingay (1965), pp 148-169.

3 Okhawa and Rosovsky (1960), pp. 61-62.

4 Erlich (1960), pp. 119-22; Nove (1969), pp. 148-86.

This picture of intersectoral relationships in the initial period of rapid industrial growth has been questioned in recent studies[1] of agriculture-industry linkages in the Soviet economy. This reinterpretation of the Soviet experience is mainly based on empirical work by Barsov.[2] Barsov's findings indicate that contrary to the widely held view agriculture's terms of trade, incorporating both the prices received by private and state farms, actually improved in the period from 1928 to 1932. The sharp rise in free market prices of farm products more than compensated for the steady level of procurement prices resulting in a shift in the terms of trade in favour of agriculture. Furthermore the findings of Barsov's study reveal that the contribution of agriculture to net investible resources was negative during the First Plan Period. Estimates of commodity flows between the farm and non-farm sector weighted by prices prevailing in 1928 show that there was a net inflow of resources into agriculture for each year with the exception of 1931.

However the validity of using 1927 prices to weight the resource flows between sectors has been questioned by Ellman in the following terms: "Given that it is suspected by many that 1928 prices were manipulated so as to extract a surplus via the price mechanism, the use of the 1928 prices to investigate the existence of the surplus is unsatisfactory. What is required for an analysis of this problem is a measure of value which is independent of prices which actually ruled in 1928."[3]

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1 Barsov (1969); Millar (1974); Ellman (1975),

2 Barsov (1969).

3 Ellman (1975), p. 854.

Alternate estimates of sectoral resource flows derived by Ellman[1] based on 1913 world prices reverse the results derived by Barsov and reveal a positive contribution of agriculture to industrialization during the First Plan period. However the results also indicate that whereas there was a net outflow from the agricultural sector the magnitude of this surplus did not increase significantly with the introduction of collectivized farming. Although collectivization was not associated with a dramatic increase in the overall flow of resources from agriculture it did lead to a sharp increase in the components of the resource flow of crucial importance to the expansion of the state industrial sector. Thus the procurement of grain - the basic wage good - doubled over the period from 1926-28 and 1930-31.[2] Furthermore there was a large increase in grain exports to pay for the heavy import requirements of the industrial program.[3]

Finally as Ellman has pointed out the negative trend in terms of trade for the non-farm sector noted by Barsov reflected the disadvantageous position of a subsector of non-agriculture- the proleterian sector - which "sold its labour power to the state and buys agricultural products at a weighted average of ration and free market prices."[4]

From the point of view of the state industrial sector the price situation vis a vis farm products was still very favourable

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1 Ibid., p. 852.

2 Karcz (1968), 241.

3 Ellman (1975), p. 846.

4 Ellman (1975), p. 850.

in that their demand for agricultural products was met at the stable official price while the prices of industrial products sold to agriculture continued to rise. However according to this view the surplus for indistrialization was provided by squeezing the working class and not the farm sector.

The conclusion derived on the basis of Barsov's results that it was the working class and not the farm sector who had to bear the burden of state accumulation during the First Plan Period has been seriously challenged in a recent work by Morrison.[1] The study through a rigorous examination of the empirical basis of Barsov's findings reveals that not only are the estimates based on crude and unreliable data but the method of measurement by using inflated prices of industrial products significantly understates the flow of resources out of agriculture. Hence the results derived by Barsov on intersectoral terms of trade of the balance of exchange between sectors cannot provide a valid basis for any generalization on the contribution of the farm sector to industrialization.

Thus although the standard version of intersectoral relationships during the First Five year plan needs to be modified to the extent that collectiveization did not result in an increase in the net flow of resources out of agriculture nevertheless it cannot be denied that the contribution of agriculture was positive and significant throughout the period. Whereas collectivization did

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1 Morrison (1982), pp. 570-584.

not lead to the extraction of a larger surplus it did provide state industry with substantially larger quantities of the vital components of the marketed surplus at very favourable prices.

Whereas in the case of Russia agricultural growth preceded industrialisation, Japanese development was characterized by concurrent growth in the leading sectors. The strategy of agricultural development assigned the highest priority to the objective of maintaining a net outflow of resources from the sector. Agricultural productivity was raised through the adoption of yield increasing technology with very little demand on the scarce resources of capital and foreign exchange. Heavy land taxation was used to solve the dual problem of curbing consumption in the rural sector and ensuring that the gains in productivity were siphoned out to finance investment requirements for industry and infra-structure. Estimates of sectoral tax burdens indicate that a disproportionately higher tax rate was imposed on agriculture as compared to the low rates for the non-farm sector. Hence, towards the end of the 19th Century, between 12% and 22% of agricultural income was paid out in direct taxes compared to the corresponding proportions of between 2% and 3% for the non-agricultural sector.[1]

The conventional view[2] of Japanese economic history outlined above has been challenged mainly in the works of Nakamura[3] and Ishikawa.[4] The contentious points are firstly the question of

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1 Okhawa and Rosovsky (1960), pp. 61-62.

2 Okhawa and Rosovsky (1960); pp. 43-68; Ranis (1959), pp. 440-454; Johnston (1951), pp. 498-513.

3 Nakamura (1966).

4 Ishikawa (1967).

concurrent growth in the two sectors and secondly the magnitude and direction of the flow of resources out of agriculture.

Nakamura has claimed that the frequently cited net agricultural growth rate of 2.3%[1] for the period from 1878 to 1917 greatly overstates the actual rate of output increase in the farm sector. The overestimation of agricultural growth is attributed by Nakamura to the fact the growth rate is based on official data which underestimates the level of agricultural production in the early Meiji period. Incomplete coverage as well as the fact that production statistics were initially collected for the purposes of land taxation and therefore incorporate various forms of concealment for tax avoidance purposes are the major reasons cited for the downward bias in official production figures for the early years of the Meiji government.

Adjusting for this bias in official statistics Nakamura has computed an alternate rate of agricultural growth. According to his estimate agricultural output, during the period under study, increased at a much lower rate of 1% which was barely equal to the rate of population increase. Consequently production per capita was, more or less, stagnant.

While denying the empirical basis of the concurrent sectoral growth thesis for Meiji Japan, Nakamura, however does not question

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[1] This estimate was derived in Okhawa et al (1968).

the importance of a transfer of resources out of agriculture in financing industrial expansion in Japan. The flow of resources out of agriculture was made possible due to a greater saving effort out of a higher initial surplus rather than through a simultaneous increase in agricultural productivity. The pre-existing surplus was mobilized through changes in the fiscal-agrarian structure during the Meiji period.

Ishikawa also shares the view that the initial conditions in Meiji Japan were exceptionally favourable but he differs from Nakamura in that he is sceptical on the supposedly large saving transfer from the farm to the non-farm sector.[1] However the significant contribution of an outflow from agriculture in financing industrial expansion is one aspect of Japanese growth on which there is a near consensus although there is some controversy regarding the principal mechanism used for channelizing income out of the farm sector.[2]

With respect to Nakamura's criticism of an upward bias in earlier estimates of agricultural growth, it is conceded that growth rates based on official data are likely to overestimate the increase in output. At the same time, however, Nakamura's estimates are considered to err on the other extreme by overstating the base year production levels. Thus Hayami and Yamada have pointed out

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1 Ishikawa (1967), pp. 318 - 320.

2 Fei and Ranis (1966) emphasize the role of direct investment by private landlords in small scale industries whereas most other writers, including Okhawa and Rosovsky (1960), Johnston (1951), have singled out the Meiji land tax as the main instrument of resource transfer.

that according to Nakamura's estimates productivity in pre-Meiji Japan was higher than that in Asian countries today. "It would seem unlikely that Japan during her feudal era could have attained a level of productivity that Korea and Taiwan under similar climatic conditions and techniques of rice cultivation have not attained to this day."[1] Johnston[2] has pointed out a further unrealistic implication of Nakamura's findings in that if agricultural output grew at a rate equal to or less than the rate of population growth the income elasticity of calories consumption of Meiji Japan was zero. Moreover there is no evidence of any drastic food shortages or inflationary pressures in the economy till 1915.[3]

The criticism of the more conventional interpretation of Japanese development discussed above, may qualify certain features of the growth experience but it does not invalidate the core of the thesis. Hence instead of exceptionally high growth from a low base there was moderate growth from a relatively higher base than previously supposed. Nevertheless the increase in agricultural output was rapid enough to cater to the food and exchange requirements of the non-agricultural sector as well as to contribute a surplus for financing industrial investment.

A similar strategy was adopted for the more recent transformation of agriculture in Taiwan. The Taiwanese experience is specially pertinent to less developed countries since the development began under comparable conditions of overpopulation and technological backwardness. Once again rapid increases in agricultural

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1 Hayami and Yamada (1969), p.111.

2 Johnston (1969), p.59.

3 Johnston (1969), p.59.

productivity were achieved through the adoption of yield increasing technology and were translated into a large net outflow of resources from the sector into non-agriculture. A detailed empirical study of intersectoral flows for the Taiwanese economy covering the period from 1895-1960 brings out the significant contribution of the net outflow of real and financial resources out of agriculture through the entire period from 1911-1960. A heavy tax burden, increase in land rent, farmer's autonomous saving and a negative price policy were the major components of the outflow. While land taxation was the principal device used for extracting the surplus in the initial period of development, in the latter phase following WWII primary reliance was placed on a negative price policy. During these years unfavourable shift in agriculture's terms of trade accounted, on an average, for nearly 50% of the large capital transfers.[1]

The experience of these countries clearly points to the stragetic role of resource flows out of agriculture in stepping up the level of capital formation concomitant with development. As noted by Johnston and Mellor. "The conclusion suggested strongly by historical experience is that in less developed countries where agriculture accounts for some 40%-60% of total national income the transition from a level of savings and investment that spells stagnation to one permitting a desirable rate of growth cannot be achieved unless agriculture makes a significant net contribution to capital formation in the expanding sector."[2] Thus the central

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1 Lee (1968), pp. 41-45.

2 Johnston and Mellor (1961), pp. 373.

problem facing planners in less developed countries is not only to raise the level of productivity in agriculture but also to ensure that the gains in productivity are channelized into industrial and infrastructural investment through an effective capital transfer mechanism.

Recently the relationship between intersectoral resource flows and development is being viewed from another angle. In his study on the poverty of Third World countries, Lipton[1] has claimed that the major obstacle to agricultural development and overall growth lies not in the difficulties of diverting the requisite surplus from the farm sector but rather from the fact that the agricultural sector is being squeezed too hard with negative production and distributional consequences. On the basis of a large sample of less developed countries the author concludes that in most cases the flow of resources not only in terms of private and public capital flows but also with respect to skilled manpower has been from the rural to the urban sector. It is further argued that the squeeze on agriculture has been affected deliberately by the state through the use of various instruments at its disposal including taxation, credit policy, manipulation of terms of trade. The latter is specially significant. "It is above all by cheapening farm output with private and public powers that transfers savings capacity from agriculture to the rest of the economy."[2]

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1 Lipton (1977).

2 Lipton (1977) p.293.

The rationale for this policy of extracting resources from agriculture does not lie in their greater productivity in the non-farm sector or any other economic motive. On the contrary, according to Lipton both the goals of efficiency and equity warrant that the surplus be utilized in the farm sector. By diverting the surplus to non-agriculture these policies "dry up the growth of specific farm outputs, of total farm products, and of marketed surpluses from agriculture, the very springs of industrialization. Their converse incentive effects on non-farm outputs seem small. Meanwhile equity as well as efficiency is damaged."[1] The only explanation for the adoption of these socially wasteful measures lies in the fact that the state is dominated by urban groups who use the government machinery to further their economic position. "In less developed countries today far more than in now rich countries it is urban interests that are the more concentrated, articulate and powerful. It is these interests that bias resource allocation away from efficiency (and I shall argue) equity as well in the direction of pushing more resources towards the cities."[2]

The urban bias thesis is significant not only because of its wide coverage which extends to a large number of countries and incorporates all elements of the resource transfer but also because of its influence on recent research on the problems of agricultural development in Third World countries. Hence the stagnation of

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1 Lipton (1977), pp. 308

2 Lipton (1977), p.48.

agricultural productivity in these countries is conveniently attributed to urban biased policies. The most damaging of these is the negative price policy. Schultz[1] points to the distortions in the price structure as the single most important cause for low levels of agricultural output. The potential of available scientific research and capital cannot be fully realized because low prices make it unprofitable to invest in modernizing investment. The limiting factor is not inadequate scientific research but lack of incentives which prevent the utilization of this research. Following Lipton's reasoning, Schultz attributes artifically low prices of farm products to direct government intervention in price setting which in turn is determined by the politically powerful urban interests. "Even though the rural population in low income countries is much the larger the political market strongly favours the urban pupulation at the direct expense of rural people. Politically urban consumers and industry demand cheap food."[2]

The shortcomings of Lipton's urban bias thesis, both at the level of empirical analysis and the theory of political economy have been pointed out in a detailed critique of the work by Byres.[3] It is shown that the claim of a substantial transfer of resources from the rural to the urban sector rests on very skimpy evidence.

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1 Schultz (1978), pp 3-25.

2 Schultz (1978) p. 10.

3 Byres (1978).

Even more damaging to the validity of the hypothesis is the "Liptonian vice" of referring only to evidence which supports his arguments as a result of which a number of important works on various aspects of intersectoral flows are not even considered in the study. Byres has pointed out these flaws in the empirical analysis with detailed reference to available evidence on India. Contrary to Lipton's thesis it is shown that research on terms of trade, taxation policy and urban rural remittances for the Indian economy, by and large, indicates that the flow of resources through these mechanisms has been to the benefit rather than the detriment of the rural sector.

A similar tendency is noticeable in Lipton's assessment of evidence for the Pakistan economy. Frequent references are made to Pakistani data to show that the price and tax policy of the government has been biased against agriculture. To substantiate the claim that farm prices have been artifically low primary reliance is placed on a study by Lewis comparing domestic and world prices of agricultural commodities from the mid fifties to the mid-sixties. However the far better-known and oft quoted works by the same author on domestic terms of trade covering the period from 1950 to 1970 are not mentioned.[1] Needless to say the results of the study show a favourable trend in agriculture's terms of trade from the mid-fifties onwards. In the same way the argument that agriculture is overtaxed relative to non-agriculture is based not on the few empirical writings on the subject,[2]

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1 Lewis and Hussain (1966); Lewis (1970).

2 Hamid (1970); Chaudhury (1973).

including a comprehensive report by the Pakistan Taxation Commission,[1] but rather on a simple manipulation of sectoral estimates of incomes and tax shares. In a later part of this study it is shown that the results of the exercise are based on incorrect data and hence cannot even serve as rough approximations of sectoral tax burdens.

Policies for agricultural development adopted by various governments in Pakistan since the late fifties were certainly not designed with the objective of providing an outflow of resources from the sector. The system of high procurement prices and generous subsidies on inputs ensured a positive trend in agriculture's terms of trade. Heavy subsidies on tractors further encouraged the tendency towards capital intensive techniques of production. Furthermore no serious attempt was made to mobilize the agricultural surplus through the tax system. Thus despite the recommendations of various tax commissions and the dramatic improvements in agricultural productivity during the sixties, farm income continued to be exempt from income tax. During the period the ratio of direct taxes to income for the agricultural sector declined from 1.7% in 1959/60 to 1% in 1969/70.

Evidence for both India and Pakistan points to the inability of these states to appropriate the investible surplus from agriculture either through price shifts or through the revenue system. As a result the gains in agricultural productivity

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1 Government of Pakistan (1960).

instead of contributing to a net outflow of resources for financing industrial investment have been accompanied by an inflow of resources into the farm sector. A recent assessment of agricultural performance for a number of Asian countries concluded that "in South Asia both the change in the terms of trade in favour of agriculture and large government investment as well as some private capital formation have resulted in a net inflow of savings. The available studies show that both in India and Pakistan there has been a perceptible change in the last decade in comparison with the fifties."[1]

Thus the direction of intersectoral resource flows for at least these two countries goes contrary to what would be expected under urban biased policies. Lipton's generalization of the urban dominated state as typical of Third World countries is not based on any detailed examination of the power structure of these states. Furthermore the concept of a single rural class in conflict with a single urban class has been rightly criticised[2] as completely inaccurate since neither sector can be said to represent a homogeneity of interests. Lipton's justification for categorizing the rural and urban sector as classes rests mainly on the supposed common interest with respect to prices within each sector. The urban sector unanimously desires cheap food while the rural sector forms a common front in favour of higher prices of farm output. However in most cases the majority of

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1 Asian Development Bank (1977), p.123.

2 Byres (1977), pp. 233-237.

the farmers operate holdings below the subsistence level and are net buyers of food. Thus the clash of interest over prices between surplus farmers who are net sellers of food on the one hand and the deficit farmers and landless labour on the other is present within the rural sector. Similarly the urban sector is even less likely to represent a harmony of interests due to the basic conflict between labour and capitalists.

Furthermore even if rural interests are identified with those of surplus farmers and the industrialists are seen as representatives of the urban sector, recent attempts[1] at class characterization of the Indian state point to an alliance, rather than a conflict, between these two dominant classes with the former playing an increasingly dominant role. The power of the landed elite is singled out as the main reason for the inability to reform the agrarian tax structure as well as for the policy of maintaining procurement prices at levels higher than those recommended by the Prices Commission[2] and thereby also an important factor in the poor saving effort in the public sector.[3] The failure to squeeze agriculture is being clearly linked to the influence of the large farmer lobby on government policies with respect to prices, tax, credit, etc.

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1 Mitra (1977), pp. 170-183; Frankel (1978), pp. 187-201; Byres (1981), pp. 443-449.

2 Rao (1974), p. 1288.

3 Shetty (1978), p. 221-222; Toye (1981), pp. 113, 238.

In this context the urban bias thesis totally misrepresents the nature of political influences on economic policy. A more relevant framework for interpreting government decision making is provided by Mitra[1] in his recent study on terms of trade. The focal point of the analysis is classes not sectors. The direction of government policy is a function of the class basis of the state reflecting the interests of the dominant classes. In the context of India the leading classes are identified as the industrial bourgeoisie and the rural oligarchs. The industrialists want control of the state machinery and the resources associated with it such as licenses, permits, loan decisions and most important the ability to influence economic policy, specially trade policy, to their benefit. Under the system of parliamentary democracy in the predominantly rural society access to the state apparatus is possible only through an alliance with the large landowners who hold sway over the countryside. In return for the rural votes the landed class demand various concessions and benefits such as higher prices, ineffective land reforms, low tax burdens etc. Hence agriculture's terms of trade have shown a positive trend from 1961 to 1974 while the contribution of the farm sector to revenues has declined consistently. The loss to the industrialists in terms of higher prices of raw materials is more than compensated by access to the state spoils system. The alliance succeeds despite the basic conflict of interest over farm prices due to the mutual benefit made possible through the control of government resources.

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1 Mitra (1977).

In Pakistan, even more so than in India, the class of rich landowners has dominated the political scene. However irrespective of this fact Lipton's urban bias thesis has been eagerly adopted by economists concerned with intersectoral relationships in the Pakistan economy specially on the question of price policy.[1] Two recent studies[2] on agricultural price policies for the early seventies blame bias against agriculture for the prevalence of artificially low prices of farm products during the period. Burki's[3] study on the economic performance of the Bhutto regime attributes the adoption of a whole host of policies from nationalization to prices to the urban bias in state decision-making. A detailed critical evaluation of these studies is provided in a later section. At this point they are mentioned to illustrate the growing tendency to resort to urban bias as the final explanation of government policies. In most of this research it has not been considered necessary to substantiate the presence of urban bias with evidence on the sectoral backgrounds of the power holders in the state. Nor is there any attempt to spell out the mechanism which has led to urban control of the state apparatus in a predominantly rural economy like Pakistan.

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1 Gotsch and Brown (1977); Brown (1978); World Bank (1979); Burki (1980).

2 Gotsch and Brown (1977); World Bank (1979).

3 Burki (1980).

The picture of a homogenuous rural sector being helplessly exploited by the politically powerful urban sector totally distorts the political realities of the country. Firstly even if the underlying assumption of homogeneity of sectoral interests is accepted, the claim that the state has represented the urban sector is untenable. A very superficial look at the political history of the country is sufficient to disprove the thesis of a government monopolized by urban groups. On the contrary, evidence presented later in the study points to the tremendous political power of the rural elite. Secondly the approach ignores the highly differentiated agrarian structure of the country which is more likely to be conducive to intra-sectoral conflict rather than a harmony of interests.

However, while on the one hand the urban bias thesis by depicting the state as the instrument of a single urban class completely misrepresented the power structure of the country, on the other hand by explicitly recognizing the political motives behind state decision making it broke away from the concept of the neutral state. The view of the state ruled by and working to the benefit of a particular group in society marked a distinct departure from previous analysis of government policy. Development research in Pakistan has tended to concentrate on questions within the very narrow confines of a neoclassical framework. Hence in earlier interpretations the state was viewed as above class and sectional interests guided

only by the exigencies of growth in it's choice of policies. The urban bias thesis brought to the forefront the link between government policies and the interests of the ruling elite, not only in connection with the question of agricultural taxation which was generally referred to in the context of political and institutional obstacles but also with respect to prices and the whole array of policies relating to the flow of resources between sectors.

The above discussion introduces the two major objectives of the present research. Firstly the study aims to provide empirical estimates for terms of trade and sectoral tax burdens for the period from 1970/71 to 1977/78. Secondly an attempt will be made to analyse changes in these variables over the period in the context of a political economy framework.

The lack of data on private capital flows makes it impossible to estimate a comprehensive measure of resource transfers between sectors. However it is possible to generate a series of inter-sectoral terms of trade and tax burdens for the seventies. The changes in these variables, the two major mechanisms for extracting the agricultural surplus, should provide an indirect assessment of the direction and rough magnitude of the intersectoral flow of resources.

At present the major work on domestic terms of trade for Pakistan has been done by Lewis and Hussain for the period from

1950/51 to 1964[1] and later updated by Lewis up to 1970.[2] The series has been further extended till 1974/75 by Gotsch and Brown[3] using Lewis' methodology. The present study will generate an alternative series of net barter terms of trade for the period from 1970 to 1978 using a more rigorous methodology and a different data base to that employed by Lewis and thereby provide a more accurate and up to date set of estimates.

Empirical work on intersectoral tax burdens for Pakistan is limited to three studies,[4] two of which pertain to the late sixties while the third empirical writing is for the year 1972/73. An attempt will be made in this study to provide estimates of tax capacity and tax burdens for the farm and non-farm sector for the period from 1972/73 to 1976/77. These estimates in conjunction with available data on inter class tax burdens in the rural and urban sector are used to examine the issue as to whether the agricultural sector is over-taxed vis a vis non-agriculture and the even more important question of whether income classes in the agricultural sector are over-taxed vis a vis corresponding income classes in the non-farm sector.

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1 Lewis and Hussain (1966).

2 Lewis (1970).

3 Gotsch & Brown (1977).

4 Hamid (1970); Chaudhury (1973); Jeetun (1978)

The other principal objective of the study will be to analyse changes in government price and tax policy in the context of the politico-economic background of the period. As mentioned earlier the interpretation of government policy in terms of political motives has only recently come into the mainstream of development literature in Pakistan via the urban bias thesis. The replacement of a neutral state with an urban dominated state may have focussed interest on non-economic determinants of government policy yet the political picture implied in the model totally misrepresents the power structure of the country. It is felt that a more relevant frame of analysis of economic policies would be provided if political influence was assessed in terms of the power of various classes, rather than sectors, along the lines suggested by Mitra's study. Hence an attempt is made in this study to assess the influence of the relative political strength of the leading classes on government decision making specially with respect to prices and taxes. Towards this objective the research will focus on the role of various classes in the political history of Pakistan - the pre-military period of 1947-1958, Ayub's regime 1958-1968, and the Bhutto government 1971-77. The discussion will focus on the influence of changes in the power structure on the economic policies of the different regimes.

The final part of the study will be concerned with tracing the detailed implications of government policies on the economic performance of agriculture, industry, balance of payments, and the rate of capital formation for the period from 1970 to 1977. The

analysis will begin with an examination of the factors determining the pattern and rate of agricultural growth. An attempt will be made to assess the extent to which government policies were successful with respect to output and distributional objectives.

The discussion of changes in the agricultural sector will be followed by an inquiry into factors influencing the level of industrial activity and investment with special emphasis on the impact of changes in output and prices of farms products on manufacturing activity. An attempt will be made to provide answers to questions such as the following: To what extent were high foodgrain prices translated into higher wages? Did the slow down in agricultural output constrain industrial production through it's effect on foreign exchange earnings or through the negative effect on profit margins?

Lastly the study will analyse the reasons behind the poor saving effort of the economy. The failure to extract an investible surplus from the largest sector of the economy will be shown to be an important factor in explaining the low level of domestic resource mobilization.

CHAPTER I

POLITICAL AND ECONOMIC BACKGROUND OF THE PRE-BHUTTO PERIOD

THE PRE-MILITARY PERIOD

Political Background

The large weight of agriculture in the economy and the highly differentiated ownership pattern within agriculture has ensured the class of large landowners a dominant place in the country's power structure.

Unlike India, which at the time of independence already had a substantial industrial base and a well entrenched capitalist class, large scale industry was virtually non-existent in Pakistan comprising only 1.4% of national income (see Table 1.4.). On the other hand agriculture accounted for over 60% of national product, provided almost all major exports and was responsible for the livelihood directly or indirectly of 80% of the population.[1]

Within the rural sector the landlords were dominant as a result of an extremely skewed land ownership pattern and a high tenancy ratio. The earliest evidence of the extent of inequality in land distribution was provided by the West Pakistan Land Reforms Commission in 1959. The data

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[1] Government of Pakistan, Planning Board, First Five Year Plan (Draft), Vol. II, 1958, p. 19.

Table 1.1

Distribution of Landowenership in Pakistan and Provinces, 1950-55

Farm Size	Pakistan		Pubjab	
	No. of Owners	Area Owned (acres)	No. of Owners	Area Owned (acres)
All Sizes	5,068,376 (100.0)	48,642,530 (100.0)	3,555,457 (100.0)	28,309,744 (100.0)
5 acres of less	3,266,137 (64.4)	7,425,614 (15.3)	2,358,119 (66.3)	4,438,517 (15.7)
5-25 acres	1,452,421 (28.7)	15,438,138 (31.7)	1,029,108 (28.9)	11,041,708 (39.0)
25-100 acres	286,470 (5.7)	10,616,308 (21.8)	146,893 (4.1)	6,198,128 (21.9)
100-500 acres	57,287 (1.1)	7,671,537 (15.8)	19,401 (0.6)	3,842,986 (13.6)
500 acres and over	6,061 (0.1)	7,490,933 (15.4)	1,936 (0.1)	2,788,405 (9.9)

Farm Size	Sind	
	No. of Owners	Area Owned (acres)
All Sizes	337,665 (100.0)	10,285,021 (100.0)
5 acres or less	100,601 (29.8)	365,817 (3.6)
5-25 acres	155,163 (46.0)	1,937,073 (18.8)
25-100 acres	54,792 (16.2)	2,390,358 (23.2)
100-500 acres	24,064 (7.1)	2,600,123 (25.3)
500 acres and over	3,045 (0.9)	2,991,650 (29.1)

Source: Government of Pakistan, Report of the Land Reforms Commission for West Pakistan, 1959. Appendix V.

Data for Punjab is for 1954-55
Data for Sind is for 1946-47

(see Table 1.1) show high concentration of land in the top classes as well as a prevalence of marginal owners with holdings of less than five acres. The very large landowners with holdings of 500 acres or more comprising .1% of all owners controlled 15.4% of the land. At the other end 64.4% of the farmers owned holdings below the subsistence level.[1] There was considerable inter-regional variation in the ownership pattern. The province of Sind had the most inequitable ownership of land resources where less than 1% of farmers with holdings of 500 acres or more possessed nearly 30% of the land. In Punjab although there was less concentration at the top, there was a far larger proportion of marginal owners -- 66% of the total as compared to the corresponding figure of 30% for Sind.

The tenancy ratio was also highest in Sind. At the time of partition 80% of cultivated holdings were under tenancy of some sort compared to 56% in the Punjab and 50% in NWFP.[2] Tenants were mostly share-croppers trading their own and their family's labour for a share in output. Their position vis a vis the landlord was one of total dependency. The landlord not only controlled his means of livelihood but usually also assumed the role of money lender. Hence the

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1 An IBRD survey in 1966 estimated the size of holding necessary to provide a minimum level of subsistence at 5 acres. The figure would vary with family size and several other considerations such as soil quality but is useful in serving as a rough approximation (World Bank, no date, Vol. 5).

2 Government of Pakistan, Planning Board, First Five Year Plan, Vol II, 1958, pp. 117-118.

economic dependency of the tenant was further reinforced by bonds of debt. The mechanisms to ensure the authority of the landlord were not limited to purely economic instruments but also included illegal violence and intimidation.[1] In such a milieu the landlords had complete monopoly of the political support of their tenants.[2]

The translation of this power at the village level into national level politics is described by Alvi in the following terms:[3]

> Political power in a village is typically organised by factions. The faction leader, typically a big landowner organises support by a variety of means. Such landowners rely on a core of supporters, namely their economically dependent sharecroppers, who have little option but to follow their master. The faction leader enters into alliances with fellow landlords who bring their economic dependents... Rival local factions are integrated with other villages and form larger factions at successive higher levels. Individuals and political parties with ambitions in district, provincial and national politics seek grass roots support with local faction leaders. Participation of faction leaders in party political competition institutionalizes alliances of factions into political parties... However because factions are based on the power of the landowning class at all levels of their organisation all factions stand for common goals on social and economic policy that embody the interests of the rural elites. At the level of national policy making it is such a leadership that participates in legislative institutions...

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1 Masud (1949), pp. 3-8; Herring (1980), p. 600; Alavi (1974), p.15.

2 Alavi (1976), pp. 353-345.

3 Ibid.

The representation of landlords in the first elected provincial assemblies reflects the efficiency with which links were established between local, provincial and national power structures. In the Punjab 80% of the seats in the provincial assembly in 1951 were captured by large landowners while the results of the Sind elections, 1955, revealed an even more complete dominance of the feudals. Ninety percent of the assembly seats were won by landlords. At the national level in the interim Pakistan assembly of 1955, out of the total of 310 members 200 belonged to this class.[1]

Furthermore an investigation[2] into the social composition of the members of the Muslim League showed that the rural elite were the major class interest represented in the party. Their importance in the party hierarchy was reflected in the control of key position such as that of secretary of the party and president of provincial committees.

The political establishment in the fifties was totally identified with landed interests. The frequent changes in the government during the period were a result of infighting

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1 Shahid Alam, "Economics of the Landed Interests," Pakistan Economic and Social Review, 1974, p. 16.

2 Sayeed (1966), p. 206.

among the feudals and a rearrangement of alliances. The increase in factional conflicts was motivated by the pursuit of power and did not signify any differences on issues that embodied their common interests.[1]

With landlords in central place in the power structure it is not surprising that there was no enactment of any form of ceiling legislation for the first ten years. Although as far back as 1949 the Agrarian Reform Committee of the Muslim League had expressed concern over the extreme concentration of land resources and stressed the importance of instituting land reforms.[2] The committee made several recommendations with respect to land ceiling,[3] redistribution of land to small peasants, taxation of agricultural income etc. These proposals were shelved. Whatever little hope there was of any land redistribution in favour of the poor peasants was crushed by the government policy of allocating land in the newly irrigated barrage areas in the Punjab and Sind to civil and military officers.[4] The position of Haris (tenants at will) was further weakened by distribution in large parcels of evacuee property in Sind to refugees from India.[5] Some reforms were enacted

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1 Maniruzzaman (1966), p. 7.

2 Pakistan Muslim League (1949), p. 6.

3 The recommended ceiling was 150 acres for irrigated land, 300 acres for semi-irrigated land, and 450 acres for wholly rainfed land. The limit to land ownership was considerably less than what was implemented ten years later by the military regime.

4 Khan (1981), p. 149.

5 Alavi (1976), p. 333.

by the provincial governments during the period with the objective of regulating tenurial relations.[1] Given the social and political environment, these reforms only served to heighten tensions between landlords and tenants while at the same time stimulating preventive action by the owners against the possibility of any further reforms.[2]

Economic Performance

At the time of independence the agricultural sector of the economy more than provided for the domestic requirements of food and raw materials. Thus in the initial years the country was a net exporter of foodgrains.[3] Similarly with respect to commercial crops, supply was considerably greater than demand as a result of the very limited manufacturing activity in the country. While Pakistan's share of cotton mills of undivided India was less than 5% it produced 40% of the raw cotton crop.[4] Hence in the early years the most urgent objective of government policy was to overcome the industrial backwardness of the

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1 These were the Punjab Tenancy Act (1950); Protection and Restoration of Tenancy Right Act of the Punjab (1950); Sind Tenancy Act (1947); Tenancy Act of Northwest Frontier Provence (1950); Protection and Restoration of Tenancy Right Act of NWFP (1950); and the Punjab Abolition of Jagirs Act (1952).

2 Khan (1981), p. 142; Hirashima (1978), p. 60.

3 Government of Pakistan, Central Statistical Office (1972), pp. 402, 404.

4 Bhatia (1979), p. 31.

country.[1] Industrialization was to proceed under the impetus of private initiative. The role of the public sector was limited to enhancing the attractiveness of private investment through the provision of infrastructureal facilities and through policies aimed at raising the returns to manufacturing activity.[2]

Primary reliance was placed on trade policy for enhancing profits to industry.[3] Thus the decision not to devalue in 1949 reduced industrial cost on imported machinery and intermediate goods as well as agricultural raw material. The imposition of quantitative controls on imports in 1952, following the collapse of the Korean War Boom, further tilted relative prices in favour of manufactured goods and created the condition for a flow of resources to industry.[4] Agriculture's terms of trade deteriorated sharply from 1951/52 to 1954/55 (Table 1.2). Other incentive measures aimed at attracting private investment included fiscal rebates, cheap credit facilities, and nominal tariffs on imports of machinery and raw material. As a result of these policies profits in the initial years were as high as 50%-100% in some cases.[5]

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1 Statement of Industrial Policy, April 2, 1948; Report of the Economic Appraisal Committee, Karachi (1963), No. 16,p. 50.

2 Government of Pakistan, Planning Board, First Five Year Plan, (1958), pp. 91-92.

3 Lewis (1969), p. 13.

4 Ibid.

5 Stern and Falcon (1970), p. 50.

Table 1.2

Domestic Terms of Trade for West Pakistan 1951-69.
(3 year moving average)

1951-54	97.39
1952-55	91.14
1953-56	87.36
1954-57	91.41
1955-58	96.03
1956-59	98.76
1957-60	99.43
1958-61	103.13
1959-62	106.39
1960-63	108.28
1961-69	107.17
1962-65	109.15
1963-66	110.01
1964-67	112.10
1965-68	108.46
1966-69	106.55

Source: 1951/54 to 1960/63 from Lewis and Hussain (1967);
1961/64 to 1966/69 from Lewis (1970)

The policy succeeded in achieving spectacularly high growth rates in the manufacturing sector. Large scale industry grew at an annual rate of over 15% during the decade from 1949/50 to 1959/60 (Table 1.3). The exceptionally high growth, while partly reflecting the smallness of the initial base, indicated the rapid response to the very lucrative investment possibilities created by government policies. Most of the investment was concentrated in consumer good industries based on agricultural raw materials. Textiles predominated contributing nearly 42% of value added in manufacturing in 1954/55 (Table 1.5). There was also a sharp increase in the share of market supplied by domestic production in the case of other consumer goods specially food, beverages, footwear, clothing, printing and publishing. However the performance with respect to investment and intermediate goods industries such as rubber products, chemicals, basic metals was poor and imports continued to provide the bulk of domestic supply.[1]

In contrast to the accelerated development in the industrial sector agricultural production stagnated during the period. Farm output failed to keep pace with population

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[1] Lewis has convincingly argued that during the initial years government policy was mainly responsible for the transfer of income to industry whereas the composition of industrial output was determined by non-policy factors such as the availability of domestic raw materials, simple technology and markets, (Lewis, 1969, pp. 154-155).

Table 1.3

Annual Compond Growth Rates by Sector at 1959/60 Factor Cost (per cent, per year) 1949/50 to 1959/60

	Pre-Plan Period 1949/50-1954/55	First Plan 1954/55-1959/60	1949/50-1959/60
Agriculture	1.3	1.4	1.2
Non-agriculture	-	-	-
(Large-scale manufacturing)	(23.6)	(9.3)	(16.3)
GNP	2.6	2.4	2.4
GNP per capita	0.2	0	0

Source: T.M.Khan and A.Bergan, "Measurement of Structural Change in The Pakistan Economy: A Review of the National Income Estimates, 1949/50 to 1963/64", Pakistan Development Review, Summer 1967.

Table 1.4

Percentage Composition of GNP in Pakistan at 1959-60 Constant Factor Cost

Sectors	1949-50	1954-55	1959-60
Agriculture	60.0	56.0	53.2
Manufacturing	5.8	8.0	9.3
(Large-scale)	(1.4)	(3.6)	(5.0)
(Small-scale)	(4.4)	(4.4)	(4.3)
All Others	34.2	36.0	37.4
Total	100.0	100.0	100.0

Source: Government of Pakistan , Planning Commission, The Third Five Five Year Plan, 1965-1970.

growth resulting in a decline in agricultural production per capita. Given the preoccupation with rapid industrial growth the question of a concerted development effort in agriculture had been largely neglected. The public sector allocation to agriculture in the first five year plan comprising only 7% of the total compared unfavourably to 31% of total development expenditure assigned to industry.[1] However substantial amounts were provided for expansion of irrigation facilities (Water and Power comprised 17% of development spending in the First Plan) mostly large scale, long gestation projects.[2] The increase in irrigated acreage did not result in a corresponding increase in cultivated area. Whereas canal irrigated land increased at an annual rate of over 2% in the first decade, cultivated area increased by only 1.22% annually.[3] Yields of all crops were stagnant or declining during the period.[4] The stagnation in agricultural output during the period cannot be entirely attributed to unrenumerative prices. As can be seen from Table 1.2 although relative prices of farm products fell dramatically in the early fifties, there was a marked rise in the farm/non-farm price ratio between 1954/55 and 1958. However the improvement in terms

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1 Stern and Falcon (1970), p. 68.

2 Stern and Falcon (1970), p. 68.

3 Hirashima (1969), p. 69.

4 Government of Pakistan, Finance Division, Pakistan Economic Survey 1977/78, p. 26.

Table 1.5

Distribution of Value-Added in the Large-scale Manufacturing Sector, Average of 1954 and 1955

Industry Name	% of Gross Value Added
Sugar manufacturing	4.6
Edible oils	1.7
Tea manufacturing	0.1
Food manufacturing, NEC	1.3
Beverages	1.5
Tobacco manufacturing	5.3
Cotton and other textiles	42.0
Jute textiles	5.6
Silk and artificial silk textiles	2.8
Footwear	2.7
Wood and Furniture	0.2
Paper Manufacturing	1.8
Printing and publishing	3.0
Leather manufacturing	1.6
Rubber and rubber goods	0.8
Fertilizer	-
Soaps, perfumes etc.	1.2
Matches	2.7
Chemicals and pharmaceuticals	2.3
Petroleum and coal manufacturing	4.5
Non-metallic mineral manufacturing	4.2
Basic metal industries	2.0
Metal Products	2.7
Machinery except electrical	1.1
Electrical machinery and equipment	0.1
Transport equipment	1.2
Miscellaneous	1.6

Source: S.R.Lewis and R.Soligo, "Growth and Structure Changes in Pakistan's Manufacturing Industry, 1954-64", Pakistan Development Review , spring 1965.

trade did not lead to a positive supply response.

The continued low levels of productivity reflected to a large extent the absence of any reform of the land distribution and tenure system. The agrarian structure certainly contained no incentive for yield raising investment either on the part of the tenant or the landlord who could receive high rents on his vast tracts of land without any effort. This fact was officially recognized in the First Plan document which singled out the land situation as the major obstacle to growth in the farm sector. "The most important cause in our view is the uncertainty which sorrounds the problem of land tenure as a result of which neither the landowners nor the cultivators feel that deep attachment to the land which derives from confidence in guaranteed possession and in exclusive and continued rights to the fruits of investment and labour."[1]

Thus over the decade while large scale industry grew at annual rates of over 16% the yearly growth rate in agriculture was only 1.2% (Table 1.3). However the dramatic disparity in sectoral growth did not have a dampening impact on the economy till the mid-fifties. Despite the large weight of agro-processing industry

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1 Government of Pakistan, Planning Board (1958), p. 19.

and the increase in industrial investment and employment, the stagnation in agricultural output did not act as a constraint on industrial investment in the early fifties. As can be seen from Table 1.6 investment in large scale industry in constant prices of 1959/60 more than tripled between the five year period from 1950/51 to 1954/55.

Although production was stagnant an increasing share of the output of commercial crops which was previously processed by the manufacturing sector in India was now diverted to the requirements of domestic industry.[1] Overvaluation of domestic currency along with export duty prevented an increase in the price of agricultural raw materials, the most important of which was cotton (Table 1.7.). Foodgrain prices were kept down by the system of compulsory delivery at low control prices (Table 1.7.) while at the same time prices of manufactured goods rose as a result of the policy of strict import controls. Despite the low levels of production agriculture was transferring resources to industry by an increasing squeeze applied through unfavourable terms of trade.

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1 Lewis (1967), p. 1155.

Table 1.6

Gross Investment in Large Scale Industry - 1948/49-1958/59 (Constant 1959-60 prices) (million of rupees)

1948-49	180
1949-50	240
1950-51	300
1951-52	440
1952-53	470
1953-54	720
1954-55	960
1955-56	650
1956-57	500
1957-58	590
1958-59	630

Source: Papanek (1964), p.31.

Table 1.7

Domestic Wholesale price Indices of Cotton and Wheat in west Pakistan - 1951/52-1963/64

(1959/60=100)

	(1) Cotton	(2) Wheat	(3) Manutactured goods
1951/52	184.3	79.6	86.91
1952/53	84.7	115.4	92.38
1953/54	84.3	89.7	100.97
1954/55	87.0	69.2	87.14
1955/56	99.5	79.5	86.89
1956/57	98.2	94.9	92.16
1957/58	96.8	94.9	98.83
1958/59	86.1	94.9	95.51
1959/60	100.0	100.0	100.0
1960/61	108.8	115.4	98.31
1961/62	100.0	107.7	99.74
1962/63	96.8	102.6	101.29
1963/64	97.2	112.8	102.22

*Value added weights

Source: Lewis and Hussain (1967)
Col. 1 and 2 pp. 44-45;
Col. 3 p. 64.

However in the mid and late fifties the continued structural imbalance in growth was reflected in a rising trend in agriculture's terms of trade (Table 1.2) and a shortage of foreign exchange resources (Table1.20). It was the last factor which by limiting the capacity to import brought industrial investment to a standstill in the late fifties.

Higher foodgrain prices did not lead to a commensurate increase in money wages and thereby to an erosion of industrial profits. The information on wages presented in Table 1.8 shows that during the four years from 1954 to 1958 there was hardly any change in money wages. The average monthly money wage for all industries was Rs. 80.52 in 1954 and Rs. 84.96 in 1958. While in the case of cotton textiles, which in 1958 employed nearly half the total workers in large scale industry,[1] the change in monthly money wage was even more insignificant increasing from Rs.80.97 in 1954 to Rs. 81.67 in 1958. The failure of money wages to keep pace with the rising price level is reflected in the fact that real wages which fell markedly in 1955 never recovered to their 1954 level till the end of the decade.

The negative impact of low rates of agricultural growth on industrial investment operated through the foreign

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1 Government of Pakistan, Central Statistical Office, Census of Manufacturing Industry 1958.

Table 1.8

Real Wages, Money Wages and Gross Value Added per Worker 1954-1969/70

Year	Index of Real Wages	Monthly Money Wages (Rs.) All Industries	Monthly Money Wages (Rs.) Cotton Textile Industry	Index of Gross Value Added per Worker
1954	103.53	80.52	80.87	-
1955	97.30	73.53	80.33	-
1957	97.12	81.32	81.08	-
1958	99.64	84.96	81.67	-
1959/60	100.00	89.23	86.47	100.0
1962/63	91.21	86.29	88.03	101.8
1963/64	92.94	92.43	97.17	110.4
1964/65	105.42	109.66	101.37	132.7
1965/66	109.30	116.25	105.08	148.8
1966/67	104.85	123.67	107.51	146.6
1967/68	105.73	128.58	106.95	158.9
1969/70	116.17	150.59	139.49	167.9

Source: N.Hamid, "The Burden of Captalist Growth", in R.Ahmed et al.(eds), Income Inequalities in Pakistan, Lahore, 1976, p.151.

exchange constraint. Stagnating farm output reduced the argicultural surplus available for export while imports of foodgrain to meet domestic consumption requirements shot up dramatically. Foodgrain imports which were negligible till 1955 comprised nearly one-fourth of total imports for the period from 1956 to 1958 (Table 1.9.). The increased domestic consumption of raw cotton caused export receipts to drop from 104.6 million dollars in 1954/55 to 44.7 million dollars in 1958/59.[1]

Although the share of foreign trade in national income was low, the level of exchange earnings was of crucial importance to the rate of capital formation due to the high import quotient of investment goods. The inability to convert rupee resources into foreign machinery led to a dramatic deceleration in industrial investment. Table 1.6 shows that investment in large scale industry in contant prices of 1959/60 fell from Rs. 96 crores in 1954/55 to Rs. 63 crores in 1959/60. In the face of continued high profits the reduction in capital formation was the result of supply forces whereby potential investment demand was frustrated due to lack of foreign exchange.

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[1] Hasan (1962), p. 51.

Table 1.9

Foodgrain Imports 1956-58 (million Rs.)

Year	Foodgrain Imports	Total Imports	(1) as percent of (2)
1956	390	1,986	19.7
1957	546	2,096	26.0
1958	437	1,888	23.1

Source: P.Hasan, Defecit Financing and Capital Formation, Karachi, 1962.

THE AYUB MILITARY REGIME 1958-1968

Power Structure

In contrast to the preceding regime Ayub Khan appointed a Land Reform Commission within four days of the military takeover in October '58 and enacted ceiling legislation less than three months later in January 1959.[1] Furthermore certain influential landlords were disqualified from political activity under the Elective Bodies Disqualification Order (EBDO) in August 1959.[2] These actions were taken by many observers to indicate a shift in the class basis of the state. It was claimed that the feudal aristocracy had been shunted out of the political arena. The civil-military oligarchy was viewed as primarily representing the interests of the monopoly capitalist,[3] while in the countryside the locus of power had been shifted to the middle farmers.[4]

The military regime's development strategy assigned

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1 West Pakistan Land Reform Regulation, February 7, 1959.

2 Under the Elective Bodies Disqualification Order (EBDO) any politician found guilty of misconduct, defined loosely to incorporate offenses ranging for subversive activity to corruption, was disqualified from holding elective office until December 31, 1966. The accused had the option of being tried for "misconduct" or disqualifying themselves from political activity (the Gazette of Pakistan, 7 August 1959). The great majority chose the latter option (Ziring, 1971, p. 14.).

3 Amjad, (1976), pp. 254-255; Rashid (1978), p. 170; Hussain (1980), pp. 36, 141.

4 Burki (1976), pp. 307-308; Joshi (1974), p. 171.

high priority to growth through industrialisation.[1] However the industrial policy did not derive from the greater political power of the industrialists during the period. As Sayeed[2] has pointed out political power in the absence of governmental position is dependent on a social base. The business class were mainly immigrants from India and had no social base in Pakistan. Hence despite the tremendous increase in their economic power during the fifties, the industrialists had not produced a single politician of note. Their access to the power structure was through an alliance with the military bureaucratic oligarchy. An alliance in which the military was very much the senior partner.

The power of the regime stemmed, first and foremost, from the military which assured it a more dominant and autonomous role in the formulation of government policy.[3] The military had become extremely powerful by the late fifties as a result of a "special relationship" with the United States which led to massive doses of technical and financial aid. According to Sayeed, the pattern of capitalist development was the institutional framework favoured by the military elite. However there

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1 Government of Pakistan, Planning Commission, (1960), p. 14.

2 Sayeed (1981), p. 51.

3 Ibid.

is no question that US economic assistance and advice, at it's peak during the early years of the Ayub regime, greatly facilitated the pattern of development that emerged.[1]

In the discussion that follows it will be shown that the claim[2] that the Ayub government significantly reduced the political and economic hold of the landed elite is not borne out either by an examination of the political system adopted by the government or by the conservative nature of the land reform legislation. It will also be argued that the argicultural policies pursued by the government placed primary reliance on the large landowner as the vehicle for the mobilization of the productivity potential in the sector.

Ayub fully realized the political expediency of establishing links between the government and the rural sector where the majority of Pakistanis lived. Political power in the countryside was the domain of the landlords. Ayub introduced a system of indirect elections, Basic Democracy,[3] with the objective of accommodating this group into the political establishment. "It was felt

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1 Laporte (1975), p. 168; Sayeed (1981), p. 51.

2 Amjad (1976), pp. 254-255; Joshi (1974), p. 171.

3 For a detailed account of the Basic Democracy System see Sayeed (1961).

that by mobilizing support from this traditionally priviledged section of rural society the regime could entrench itself for a long time to come."[1]

Murdal[2] has pointed out how the system of Basic Democracies further strengthened the position of the local landlord. Firstly, the smaller electorate was easier to manipulate. Secondly, the condition that the candidate had to reside in the locality eliminated any possibility of alternative leadership from outside. Evidence[3] on the social composition of the Basic Democrats showed that 62% were from the traditional landlord class. In areas where the large landlords had been disqualified it was their agents who were elected. "Thus in certain areas of West Pakistan where large landlords or ex-military officers dominate it has been difficult to find alternate leadership."[4] Maniruzzaman[5] has compared the social backgrounds of members of national and provincial assemblies in 1962 and 1965 with that of assembly members in the pre-military period. The proportion of landlords in the legislature was 58% as compared to 68% in the earlier period considered to be the heyday of landlord rule.

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1 Ayoob (1971), p. 201.
2 Myrdal (1968), p. 11.
3 Khan (1981), p. 168.
4 Sayeed (1961), p. 257.
5 Muniruzzaman (1971), p. 226.

These results do not support the thesis of a major restructuring of power relations in the country. As Alavi[1] aptly points out the system did not bring about a shift in political power but a change in it's mode of articulation. Instead of exercising influence on policy making at the national level, the landed elite now affected administration locally through elected chairmen who had links with the administrative structure as well as the political faction at the village level.

Even before any attempts to introduce the elective principle the conservative character of the land reform enacted by the government indicated clearly that the objective was to establish the legitimacy of the military regime rather than to curtail the land monopoly of the rural elite.[2] The generous ceiling of 500 acres of irrigated land and 1000 acres of unirrigated land was applicable on an individual rather than on a family basis.[3] The ceiling was also fixed in terms of produce index units which were based on revenue settlements conducted before 1947 and thereby considerably underestimated the current productivity of land. Allowance of transfer to heirs, gifts

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1 Alavi (1976), p. 343.

2 The view that the '59 land reform made no significant impact on the distribution of land resources is supported by most observers including Sanderatne (1974), pp. 127-128; Hirashima (1978), p. 61; Khan (1981), pp. 161-170.

3 Details of the 1959 land reform are provided in West Pakistan Land Reforms Regulation, Febuary 7, 1959.

Table 1.10

Appropriation and Distribution of Land by th 1959 Land Reform: West Pakistan (December 1964)

1. Total Number of Declared Landlords	5,218
a. Affected Landlords	755
b. Unaffected Landlords	4,463
2. Total area Declared (acres)	7,313,940
a. Declared by Affected Landlords	3,986,286
b. Retained by Affected Landlords	1,458,973
c. Alienated to Heirs	309,728
d. Given to Female Dependents	22,281
3. Total Area Appropriated (acres)	2,195,304
a. Produce Index Units	29,131,824
b. Under Cultivation	939,450
c. Not Being Cultivated	1,225,854
i. Culturable Waste	699,438
ii. Forest	196,675
iii. Hill	131,170
iv. River	100,080
v. Other	128,491
4. Total Area Distributed	762,539
a. Sold to Tenants	654,411
b. Sold to Small Owners	25,708
c. Auctioned	85,420
5. Total Number of Beneficiaries	59,468
a. Tenants	56,906
b. Smaller Owner Farmers	2,562

Source: S.Hirashime, Structure of Disparity in Developing Agriculture, Tokyo, 1978.

various exemptions for orchards, mechanized farming were also fixed both in terms of acres and produce index units. It has been estimated that the effective ceiling taking advantage of the various exemptions in the PIU's was between two thousand to three thousand irrigated acres.[1]

The ineffectiveness of these land reforms can be judged by the fact that out of the total of 5218 landlords who declared land in excess of the ceiling, only 14% actually surrendered land (Table 1.10).The average holding of the affected landlords after the transfer of land was estimated at 2372 acres.[2] These figures indicate that the land reforms had a negligible impact on the vast land-holdings of the feudals.

Agricultural Policy and Performance

Recognising the structural bottlenecks imposed by a stagnating agriculture, the Ayub regime gave high priority to the problem of raising farm productivity. The allocation to the agricultural sector was increased considerably from 7% in the First Plan to 13% of total development expenditure in the Second Plan.[3] Primary reliance was placed on a system of incentives, comprising of high support prices and input subsidies, to

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1 Khan (1981), p. 159.

2 Hirashima (1978), p. 61.

3 Government of Pakistan, Planning Commission, Second Five Year Plan, (1960), p. 12.

stimulate investment and production in the sector.[1] Prior to 1959 the foodgrain market was characterized by restrictions on foodgrain movement, compulsory procurement and price controls. The Ayub government abolished restrictions on foodgrain movements and replacement controls by a minimum guaranteed price of Rs. 13.50 per maund of wheat.[2] The export tax on cotton was reduced from Rs. 115 per bale in 1958 to Rs. 25 in 1964/65.[3] In addition subsidies were provided on nearly all inputs including irrigation water, fertilizers and seeds while plant protection was provided free of charge.

The performance in the agricultural sector was impressive. Compared to a growth rate of 1.2% in the previous decade gross product in agriculture increased at an annual rate of 3.7% over the period from 1960/61 to 1969/70 (Table 1.11). In the latter half of the sixties (1965-70, the Third Plan period) the rate of agricultural growth accelerated further, rising as high as 6.5% in the case of major crops.

An official assessment of determinants of growth in the

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1 Ibid., P. 404.

2 Government of Pakistan, Finance Division, Economic Survey, 1961/62, pp. 143-144.

3 Government of Pakistan, Finance Division, Economic Survey, 1964/65, p. 15.

Table 1.11

Annual Growth Rate of Gross Agricultural Product (GAP): West Pakistan, 1960/61-1969/70 (1059/60 Constant Prices)

	1960/61-1969/70	1960/61-1964/65	1965/66-1969/70
GAP	3.7	3.4	5.5
GAP per capita	1.1	0.9	2.8
Major Crops	4.2	3.9	6.5
Minor Crops	4.3	3.6	7.0

Source: Government Of Pakistan, Pakistan Economic Survey, 1970/71 and 1971/72

Note: Estimted by log Y=a+bt.

Table 1.12

Source of Increased Output During the Second Plan Period, 1960-65

	percent
Groundwater Development	9
Additional Surface Water	4
Fertilizer	5
Plant Protection	4
New Seed	3
Other Factors	1
Total Increase in Output	26

Source: Government of Pakistan, Planning Commission, The Third Five Year Plan, 1965.

period from 1960-1965 (Table 1.12.) attributes nearly half the improvement in farm output to increase in water availability with tubewell irrigation contributing nearly 70% of the additional water supply. It is widely agreed that[1] tubewell irrigation, an element not even considered in the official strategy, was the "leading input" which triggered off the spurt in agricultural growth in the sixties. There are various explanations as to what initiated the phenomenal increase in tubewell installations. Hirashima[2] cites the desire to escape land reforms legislation as the main motivating factor while Mohammed[3] lays greater emphasis on the provision of electricity to the rural areas. Whatever the reason for the initial move, once the landowners discovered their tremendous productive potential the use of tubewll irrigation spread dramatically. The purchase of private tubewells increased from 3400 in the period 1955-59 to 25450 in the years from 1965-68 (Table 1.14). The abundant and controlled water supply permitted higher cropping intensities and greater flexibility with regard to the crops that could be grown. The timely availability of water was also an

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1 The importance of tubewell irrigation as a catalyst in the agricultural breakthrough in the sixties was first pointed out in the empirical work by Ghulam Mohammed (1965) on the spread and productivity potential of tubewells. Other economists who have emphasised the crucial role of tubewells as the leading input include Alavi (1976); Nulty (1972); Burki (1976).

2 Hirashima (1978), p. 73.

3 Mohammed (1965), p. 43.

4 Ibid., p. 44, Kaneda and Ghaffar (1969), p. 8.

Table 1.13

Source of Irrigation in West Pakistan 1948/49-1968/69 ('000 acres)

	1948/49	%	1958/59	%	1968/69	%
Government Canal	17,430	82.3	20,911	82.6	21,069	68.1
Private Canal	572	2.7	494	2.0	850	2.7
Tank	21	0.1	146	0.6	29	0.1
Well	2,260	10.7	1,923	7.6	2,204	7.1
Tubewell	-	-	303	1.2	2,857	9.2
Other	1,531	7.2	1,543	6.1	3,936	12.7
	21,171	100	25,320	100	30,945	100

Source: Government of Pakistan, Yearbook of Agriculture Statistics, 1969.

Table 1.14

Number of Tubewells Purchased in the Four Provinces: West Pakistan 1947-68

	1947-54	1955-59	1960-64	1965-68	Total
Punjab	1,030	2,800	23,900	41,300	69,030
NWFP	160	300	710	1,390	2,560
Sind	500	250	580	1,290	2,620
Baluchistan	90	50	260	1,110	1,510
Total	1,780	3,400	25,450	45,090	75,720

Source: Government of Pakistan, A Report on Farm Mechanization Survey, 1969.

essential prerequisite to the application of chemical fertilizers and high yielding seed varieties.

Thus although seeds and fertilizers were highly divisible inputs they required supporting tubewells technology. Furthermore it has been demonstrated that complementarity of inputs was an essential pre-requisite to realising the yield potential of the bio-chemical technology. Yields and income were maximised at higher doses of water and fertilizers as compared to traditional methods.[1] Given these conditions and the highly skewed access structure of the Pakistani rural sector it was inevitable that a disproportionate share of the gains from the technological breakthrough would accrue to the dominant class of large farmers.[2] The superior resource

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1 Nulty (1978), p. 70; Hirashima (1978), p. 78.

2 A contrary view has been put forward by Burki (1976, pp. 307- 311). He maintains that it was the middle farmer, defined as owning between 50 and 100 acres of land, who responded and benefited most from the technological developments during the period. It is further argued that the agricultural policy was a response to the growing political power of this group and was aimed at strengthening their economic position. While the system of Basic Democracies was the vehicle designed for their political emancipation.

The question arises as to why the larger, wealthier landowners did not respond equally, if not more so, to the very lucrative opportunities for agricultural investment at the time. They certainly had the capital and influence to ensure easy access to modern inputs. The answer, according to Burki, lay in the distinctly different objectives of the two class of farmers. "The rural middle class constituted a social strata different from that of the landed aristocracy and it's economic, social and political goals and the nature of the constraints facing it are not the same as those of the big landlord." The large landowner was a "political maximizer" motivated mainly with bringing more area under his control and social influence as compared to the middle farmer whose objective was to maximize economic returns through more intensive cultivation of land.

endowments of this group not only enabled a greater

Burki's claim of the greater productivity of middle sized farms rests on two empirical exercises. The first of these is based on time series data on rent per acre by size class for 27 villages covering the period from 1948/49 to 1968/69. The rent series for the size category between 25 to 50 acres registered the largest increase over the period followed by size holdings of between 50-100 acres. On the other hand rent accruing to the largest size group between 250-500 acres did not show any significant increase after 1959. Using rent as a proxy for land productivity Burki concludes that the data substantiates the thesis of the greater productivity of middle sized farmers as compared to the large landowners.

The second exercise consists of regression analysis based again on time series data for the 27 villages. The dependent variable is the average per annum rate of growth of crop output while percentage of land owned for a specific size class is the independent variable. A separate regression was estimated for each of the following size categories of farms: 11-25 acres, 26-50 acres, 101-500 acres, 25-100 acres. The model had the greatest explanatory power when the independent variable was the area under size class of 25-100 acres. This specification explained more than 88% of the rate of growth of crop production.

Hussain in a recent study (1980, pp. 142-146), has pointed out conceptual and statistical errors in Burki's empirical work which render his conclusions invalid. Firstly he points out that Burki's use of rent as an index of increasing land productivity would be valid only under the condition if the increase in rent was the result of increased profitability and not due to the greater bargaining power of the landlords. Secondly Burki derives rent by multiplying physical output received by landlord with current average price. Since wholesale food price increased by 34% in the sixties, the steady level of money rent for the largest size group during the period indicates a decline in physical output for which there is no rational reason. Finally Burki's data refer to operated holdings and not ownership size groups. There is no reason for the two to coincide. On the contrary, as Hussain has noted, a landlord owning a holding of 50-100 acres is more likely to rent it out in the conventionally smaller parcels of 12.5 acres or 25 acres depending on whether the tenant owns one or two pair of bullocks.

The limited research on size and productivity in the farm sector for Pakistan reveals either a positive association between productivity and size (Khan, 1979, p. 76; Hussain, 1980, pp. 270,273) or a U shaped land productivity curve where productivity is highest for the smallest and largest size groups (Mahmood and Haq, 1980, p. 186). However large farms are classified as holdings of 25 acres or more in the Khan study and as holdings of greater than 50 acres in the Mahmood and Haq paper whereas Burki defines middle farmers as owning land between 50 to 100 acres. The findings of the only work with roughly similar classification (Hussain, 1980, pp. 270-273) show that both use of modern inputs and gross yield per acre are positively related to farm size.

Finally the suggestion that the indirect elections resulted in a restructuring of the power in the countryside in favour of the middle farmers is disproved by evidence provided earlier on the continued representation of the landed aristocracy in the political arena.

capacity to take risks but also to combine the inputs in amounts necessary to optimize returns.

Evidence about the diffusion of technology for Pakistan reveals a fairly widespread adoption of improved seeds and fertilizers although the intensity of fertilizer use per acre was significantly higher for large farms.[1] Even more important was the differential in access to tubewell irrigation by farm size. The Farm Mechanization Survey of 1968[2] shows a large concentration of tubewells in farms of 25 acres or more. Nearly 69% of the total belonged to this category while only 4% were owned by farms of less than 13 acres (Table 1.15). The distribution of tractors was even more skewed with 74% of the total concentrated in farms of fifty acres or more.

The negative distributive effects of the technology derived from the initial inequality in distribution of resources was further accentuated by the agricultural policies pursued by the Ayub regime. Public resources in the agricultural sector were mainly concentrated in maintaining high procurement prices, low rates of institutional credit, and subsidies on inputs such as fertilizers, canal water, tubewells etc.[3] Although there was no direct subsidy on tractor purchase, duty free imports at the official exchange rate meant that cost per tractor horsepower

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1 Khan (1975), pp, 112-115; Ercelawn (1979), p.23 IACA-IBRD (1966), pp. 84, 105.

2 Government of Pakistan, Central Statistical Office (1968).

3 Government of Pakistan, Planning Commission (1960), p. 404.

Table 1.15

Distribution of Tubewells and Tractors by Size of Holdings: West Pakistan 1968

Size of Holdings (acres)	Number of Tractors	%	Number of Tubewells	%
0	574	3	4,680	7
-13	450	3	3,320	4
14-25	1,025	6	15,240	20
26-50	2,326	14	18,050	24
51-100	3,407	21	14,240	19
101-200	3,094	19	9,120	12
201-500	3,238	19	5,550	7
500-	2,469	15	5,520	7
	16,583	100	75,720	100

Source: Government of Pakistan, A Report on Farm Mechanization Survey, 1969.

Table 1.16

Number of Tractors Working in Irrigated and Unirrigated Area: West Pakistan 1968

Irrigated Area	Tractors	%	Unirrigated Area	Tractors	%
Canal & Tubewell	10,323	62	Barani	239	2.0
Tubewell	1,685	10	Salabi	24	0.5
Well	114	1	Others	161	1.0
Karez	76	0.5			
Perennial Canal	3,338	20			
Inundation Canal	623	4			

Source: Government of Pakistan, Report on Farm Mechanization Survey, 1969.

was less in Pakistan than in the country of origin.[1] Access to these subsidised inputs and thereby the benefits of the incentive strategy was directly determined by the influence and financial position of the farmer which in turn was strongly related to the control of land resources.[2]

Evidence on the distribution of credit indicates that access to the subsidised credit provided by the government sponsored Agricultural Development Bank during the period was limited to farms of 25 acres or more.[3] The various modifications in collateral requirements were not effective in ensuring a wider dispersion of credit. The highly discriminating attitude of credit agencies against small farms, specially with respect to loans for durable goods, has been noted by Yousaf and Gotsch. "For years Pakistani cultivators who owned less than 25 acres could not obtain funds to purchase a tubewell. This despite the fact that the collateral represented by their land-holdings was more than that required to guarantee the costs of the well. The reasoning of officials who were responsible for the regulation was that a tubewell obviously had the capacity to irrigate two or three times that much land and thus the 25

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1 Base and Clark (1969), p. 284.

2 The negative distributional impact of the incentive strategy and technological developments in the sixties have been stressed by Yousaf and Gotsch (1975); Amjad (1972); Alavi (1976); Gotsch (1976); Falcon (1970); Nulty (1972); Kaneda (1969); and Khan (1975).

3 Gotsch (1976), p. 372.

acre holding was clearly too small."[1]

Large farmers were also the main beneficiaries of the policy of high procurement prices and subsidised inputs. Studies on the distribution of fertilizers[2] confirm that in a situation of excess demand at the low price the influential upper strata are able to appropriate the bulk of supply. High support prices also confer disproportionate benefits to large farmers who on the basis of available evidence[3] market a far greater proportion of their output as compared to their smaller counterparts. Finally the large farmer bias is most obvious in the policy of maintaining artifically low prices of tractors whose use is almost entirely confined to farms of 50 acres or more. As can be seen in Table 1.15., 74% of the tractors were owned by holdings in this size group.

The developments during the sixties, in certain ways, increased the dependence of small farmers and tenants on the wealthy landowners. The resumption of land for self cultivation and increase in the size of the mechanized farm sector led to increased vulnerability of the lower strata of rural society.

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1 Yousaf and Gotsch (1975), p. 97.

2 Dalrymple (1975), pp. 3-17.

3 Ercelawn (1980), pp. 236-237; Government of Pakistan, Ministry of Food and Agriculture (1976), p. 6; Raquibuzzaman (1966), p. 381.

Evidence for the Punjab[1] based on a comparison of Census data for 1962 and 1972 shows a sharp rise in landlessness and marginal farms. Also the tenants and small owners became more dependent on the influence of large landowners for procuring modern inputs in supply scare conditions. The latter's direct control of inputs such as water further strengthened their hold on the less priviledged groups.

The landlords emerged economically stronger with their power undiminished by the institutional changes and technological developments in the sixties. They continued to exert strong influence on government and administration and were successfully able to resist any pressure which would affect their interests.

The reversal of the government attitude towards tractorisation serves to illustrate the ability of the rural elite to manipulate public policy to their advantage. The Pakistan Agricultural Enquiry report of 1951/52[2] had cautioned against the widespread imports of tractors because of their labour displacing and foreign exchange using qualities. By 1960 the Food and Agriculture Commission[3] re-examined the case

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1 Hussain (1980), pp. 203-209.

2 Ministry of Food and Agriculture (1952), p. 11.

3 Food and Agriculture Commission (1960), p. 106-108.

for tractor mechanization. This time the response was favourable and the output increasing effects were emphasized. From 1952 tractors could only be imported under the commercial license scheme through established agents. By 1961, however, there was a change in this policy tractors could now be imported on Open General License whereby anyone wanting to import them was alloted foreign exchange.[1] The cost of imports was 20-30% less under this scheme as compared to the commercial license scheme.[2]

The availability of institutional credit at very low interest rates also played a major role in the spread of tractors. In 1964/65 a third of all loans granted by the government sponsored Agricultural Development Bank were for purchases of tractors and other mechanical equipment.[3] The number of tractors purchased increased from 667 in the period from 1955-59 to 4031 in the four years from 1960-1964 (Table 1.17.). Heavy subsidy on tractor use was directed towards the landed elite. The concentration of tractor ownership can be guaged from the fact that holdings of 100 acres or more represented 86.5% of the total area in the mechanized sector.[4]

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1 Government of Pakistan, Finance Division, Economic Survey 1961/62, p. 29.

2 Hirashima (1978), p. 75.

3 Government of Pakistan, Ministry of Food and Agriculture, Agricultural Statistics 1967, p. 202.

4 Alavi (1976), p. 339.

Table 1.17

Number of Tractors Purchased in Four Provinces: West Pakistan 1947-1968

Province	1947-54	1955-59	1960-64	1965-68	Total
Punjab	233	472	2,949	11,369	15,023
NWFP	31	49	184	755	1,019
Sind	69	122	849	1,519	2,559
Baluchistan	11	24	49	224	308
Total	344	667	4,031	13,867	18,909

Source: Government of Pakistan, A Report on Farm Mechanization Survey, 1969.

Table 1.18

Direct Agriculture Taxes 1959/60-1968/69

Years	Proportion of Agricultural Income	Proportion of Provincial Taxes
1959/60	2.2	-
1960/61	2.0	60.8
1961/62	1.8	50.5
1962/63	1.7	46.7
1963/64	1.6	44.3
1964/65	1.5	41.0
1965/66	1.6	39.8
1966/67	1.2	36.2
1967/68	1.2	37.3
1968/69	1.2	46.4

Source: J.Hamid "Suggested Approach to Agriculture Taxation Policy in West Pakistan", Pakistan Development Review, 1974.

Similarly the influence of the landlord lobby on the setting of procurement prices has been noted by a number of observers.[1] Hence the support price of wheat was raised from Rs. 13-50 per maund to Rs. 17 in 1967 despite the unanimous opposition by economists and planners who felt that a much lower price of Rs. 15 would have been more than sufficient to maintain incentives for the spread of the new technology. In the words of a then member of the Planning Commission "providing these windfall gains to essentially prosperous farmers was totally unjustified socially, particularly because mobilization of the additional income in the form of a tax on agriculture proved very difficult."[2]

Despite the tremdous gains accruing to the landed elite the government was unwilling to tax agricultural income on some feeble pretext or the other -- whether it was administrative inconvenience or the disincentive effect on production. The report of the Taxation Enquiry Committee presented to the Ayub government in 1960 clearly stated that the burden of direct taxes on the agricultural sector was inadequate.[3] The committee strongly recommended that the present system of levy surcharges

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1 Gotsch (1976), p. 259; Nulty (1972), p. 96; Hasan (1976), p. 236.

2 Hasan (1976), p. 236.

3 Government of Pakistan (1960), p. 39.

on land revenue be abolished and replaced by an effective tax on agricultural income subject to a progressively rising rate.[1] In spite of the urgent emphasis on this proposal and the subsequent sharp increases in agricultural output and prices, no attempt was made to reform the system of agricultural taxation. The ratio of direct taxes to income in the agricultural sector continued to decline during the sixties falling from a low level of 2.2% in 1959/60 to 1.2% by the end of the decade (Table 1.18).

A more detailed discussion of the determinants of public policy with respect to prices and taxes in the farm sector is presented in chapters 4 and 5 of this thesis.

Development Strategy, Industrial Growth, Savings and Capital Formation

The approach to agricultural development reflected the overall development strategy of the government which was to create a favourable environment for private investment through a system of concessions and subsidies. Direct investment in industry by the public sector was to be undertaken "only in those activities which are not ordinarily developed with private capital and where on present indication private investment was not forthcoming"[2]. Industrialisation was to proceed under private

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1 Government of Pakistan (1960), pp. 112-115.

2 Government of Pakistan, Planning Commission (1960), p.8.

initiative with the state providing "maximum encouragement."

The approach was essentially a continuation of the strategy initiated in the fifties whereby industrial growth, savings and capital formation were to be achieved by a transfer of income to the capitalist class through a host of government policies. In the Ayub period these incentive measures included protection from foreign competition, an overvalued currency, nominal tariffs on imports of industrial raw materials and machinery, low rates of direct taxes, liberal depreciation allowances, low interest loans from government sponsored credit agencies and the absence of any anti-monopoly legislation.[1]

Furthermore in contrast to the fifties when stagnation in agriculture had a constraining effect on industrial investment, the sixties were characterized by a tremendous improvement in farm productivity. However the high growth rates in agricultural output did not lead to favourable relative prices for manufactured products. The intersectoral terms of trade which had started moving against industry in the mid-fifties continued to shift in favour of agriculture (Table 1.2).

High food prices were not translated into higher wages and thereby an erosion of industrial profits. Information on real wages, money wages and labour productivity is provided

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[1] Griffin and Khan (1972), pp. 13-14.

in Table 1.8. The data show that there was little change in money wages and a continued deterioration in real wages in the early sixties. Following increased labour unrest[1] and substantial improvements in labour productivity, money wages were raised in 1965 by 19% for all industries. The resulting positive trend in real wages was reversed in the subsequent period when money wages again lagged behind price changes leading to declining real wages till 1968. The decreasing share of wages in industrial income can be gauged from the fact that over the period from 1959/60 to 1967/68 the index of real gross value-added per worker increased by 59% while monthly real wages went up by only 6%.

Moreover the shortage of foreign exchange, a major bottleneck to the expansion of industrial investment in the late fifties, was no longer a limiting factor due partly to rapid agricultural growth and subsequent increase in export earlings but mainly due to the massive inflow of foreign assistance during the period. Foreign aid increased threefold between 1960 and 1964 rising from 3.4% of GNP to 7.5% (Table 1.21). Export earnings registered an annual growth rate of 7% during the Second Plan period exceeding the plan target.[2] The main boost to earnings came from agricultural commodities with

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1 According to information compiled by CSO (Pakistan-Twenty Five Years in Statistics, 1972, pp. 38-39) the number of industrial disputes increased from 45 in 1961 to 87 and 153 in 1963 and 1964.

2 Government of Pakistan, Planning Commission (1965), p. 81.

Table 1.19

West Pakistan Exports,1955-68

Value in Rs. figures in brackets are percentages.

	1955	1959	1964/65	1967/68	Annual Growth Rate 1955-67/68
Rice	59 (9)	52 (9.7)	119 (10.4)	149 (9)	7.7
Raw and waste Cotton	406 (64)	127 (24)	316 (28)	442 (27)	.7
Raw Wool and Other Raw Wool and Other Animal Hair	67 (10.6)	62 (11.6)	70 (6.1)	43 (2.6)	-3.5
Fish Fresh Dried Proccessed	5 (.7)	6 (1)	41 (4)	45 (2.7)	19.2
Other Primary Goods	38 (6)	46 (8.7)	137 (12)	176 (11)	13.1
Primary Commodities	575 (91)	303 (57)	638 (60)	855 (52)	3.2
Cotton Textiles	8 (1)	146 (27)	271 (24)	422 (30)	37.2
Other Textiles	5 (.7)	12 (2.2)	34 (3)	128 (6.8)	29.6
Tanned Leather and Leather Goods	17 (3)	38 (7)	73 (6)	113 (7)	16.4
Metal Goods	10 (1.5)	11 (3.1)	28 (2)	32 (2)	9.8
Cement and Cement Manufactures	1 (.1)	-	-	10 (.6)	20.2
Other Manufactured Goods	14 (2.2)	21 (4)	51 (4.4)	85 (5)	15.5
Manufactured commodities	55 (8.7)	228 (43)	457 (40)	790 (48)	23.8
Total Exports	630	531	1140	1645	

Source: G.C.Hufbauer, "West Pakistan Export: Effective Taxation Policy, Protection and Sectoral Discrimation" in W.P.Falcon and G.F.Papanek (eds.), Development Policy II The Pakistan Experience.

manufacturing sector contributing little to the expansion in exports. The contribution of primary commodities to exchange earnings increased from 57% in 1959/60 to 60% in 1964/65 while foodgrain imports declined (Table 1.19).

Despite the exceptional export performance, the balance of payments gap widened dramatically over the period as a result of the sharp increase in imports (Table 1.20). The rapid increase in imports, concommitant of the ambitious development program, was made possible due to a large inflow of foreign assistance. Table 1.21 reveals the increasing dependence of the economy on foreign aid. Thus while foreign aid financed 18.6% of total imports and 34.8% of development expenditure in 1956, the corresponding proportions for 1964 were 55.8% and 42.2% respectively.

The relaxation of the foreign exchange constraint and the continuing high rates of profits, largely attributable to government policies, gave a powerful impetus to industrial investment. In terms of 1959/60 prices private investment nearly doubled from Rs. 1720 in 1959/60 to Rs. 3320 in 1964/65 (Table 1.23) overshooting the Second Plan target. Public investment also increased significantly over the period. Total gross investment reached it's highest ever level in 1964/64 when it was 23.2% of GNP (Table 1.24).

Table 1.20

Balance of Trade 1959/60-1969/70

(million Rs.)

Year	Imports	Exports	Balance
1958/59	1,024.6	444.4	-580.2
1959/60	1,805.7	763.1	-1,042.6
1960/61	2,173.2	540.2	-1,633.0
1961/62	2,236.3	542.9	-1,693.4
1962/63	2,800.1	998.1	-1,802.0
1963/64	2,981.6	1,075.0	-1,906.6
1964/65	3,672.4	1,139.6	-2,532.8
1965/66	2,880.3	1,203.6	-1,676.7
1966/67	3,625.7	1,297.3	-2,328.4
1967/68	3,327.2	1,644.8	-1,682.4
1968/69	3,046.6	1,699.9	-1,346.7
1969/70	3,285.1	1,608.6	-1,676.5

Source: Government of Pakistan, Economic Survey, 1976/77.

Table 1.21

Foreign Aid Compared with Income, Development Expenditure and Imports

	1952	1956	1960	1964	1968
Foreign Aid (Rs.million)	5	472	1068	3105	3577
Proportion of GNP (%)	.02	2.1	3.4	7.5	5.8
Proportion of Development Expenditure (%)	.5	34.8	38.1	42.2	34.0
Proportion of Imports (%)	.1	18.6	31.1	55.8	49.8

Source: B.M.Bhatia, Pakistan Economic Development, New Delhi, 1979.

Table 1.22

Foreign Economic Assistance (dollars millions),1950-1968

Period	Total	Grants	Loans
Pre-plan (1950-1955)	371	67%	33%
First Plan (July 1955-June 1960)	990	58%	42%
Second Plan (July 1960-June 1965)	2,377	14%	86%
Third Plan (July 1965-December 1968)	1,770	6%	94%

Source: Government of Pakistan,Economic Survey, 1968/69.

Table 1.23

Relative Share of Public and Private Fixed Investment
(Million Rs) (1959-60 prices)

Type of Investment	1949-50	1954-55	1059-60	1964-65	Annual Compound Rate of Growth
(Million Rs. : 1959-60 prices)					
Public Investment	310	610	1,710	3,070	16.5
Private Investment	810	1,590	1,720	3,320	9.9
Total Investment	1,120	2,200	3,430	6,390	12.3
Public Investment as percent of Total Investment	28	28	50	48	

Source: Government of Pakistan, Third Five YEar Plan, 1965.

Large scale industry recorded growth rates of 16.9% over the plan period despite the much greater value of the base. Although output of Intermediate and Investment goods sectors increased at higher than average rates during the early sixties, the manufacturing sector continued to be dominated by consumer goods industries. Hence by 1964/65, despite the tremendous expansion in industrial output, domestic production provided only 22% of the total supply of machinery (including electrical), 24% of transport equipment and 44% of basic metals and metal products.[1]

The economic performance in the Second Plan was widely acclaimed as a tremendous achievement despite the failure to develop a balanced industrial structure. The capacity to import continued to be a limiting factor to capital formation. The easy availability of aid made it possible to avoid politically difficult issues which were crucial to any long term sustained development effort. Thus there was no rigorous attempt at mobilizing domestic resources or to move beyond the consumer goods oriented industrial structure.

The fragile base of the "spectacular growth" was exposed at the end of the Second Plan period when following the '65 War the flow of foreign aid was sharply curtailed. The rate of

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[1] Lewis (1969), p. 124.

investment dropped dramatically from 23.2% of the GNP in 1964/65 to 17.7% in the following year. As a result of a marked fall in farm output in the two successive drought years of 1965/66 and 1966/67, there was a steep increase in the import of foodgrains. In 1966/67 the share of foodgrains in total imports was second only to that of machinery.[1] The ratio of gross investment to GNP continued to decline throughout the Third Plan period (Table 1.24). Whereas private fixed investment in current prices increased at an annual rate of less than 1%, the overall price index rose by more than 20% over the period implying a significant decrease in investment in real terms.[2]

The deceleration in the pace of industrial growth was less marked. Value-added in industry increased at the rate of 10.1% per annum as compared to 16.9% over the Second Plan. However, at a more disaggregared level, the progress of intermediate and investment good industries was considerably below average. Thus for the period from 1963/64 to 1970/71 while the growth rate in the consumer goods sector was 11% (compared to the overall average of 9%), the output of intermediate goods increased at an annual rate of 5.7% while the investment goods sector grew at the rate of only 1.7% per annum (Table 1.25).

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1 Government of Pakistan, Economic Survey 1967/68, p. 135.

2 Government of Pakistan, Planning Commission, Fourth Five Year Plan, (1970), p. 79.

Table 1.24

Investment and Savings Ratio - 1960/61-1969/70
(Current prices)

(percent)

Year	Gross I/GNP	Gross Domestic Savings /GDP
1960/61	16.1	8.5
1961/62	18.7	10.5
1962/63	21.7	13.9
1963/64	20.6	12.9
1964/65	23.2	12.8
1965/66	17.7	11.9
1966/67	17.9	11.8
1967/68	17.0	11.4
1968/69	16.8	13.5
1969/70	15.9	12.7

Source: S.M.Naseem, Underdevelopment, Poverty and Inequality in Pakistan, Lahore, 1982.

Hence, in 1970 out of the total value-added in the manufacturing sector 80% was attributable to consumer goods, 7% to intermediate goods and 13% to investment goods (Table 1.26). As much as 82% of the total availability of machinery and transport equpiment continued to be supplied by imports.[1] After twenty years of "spectacular" industrial growth the country had not proceeded far beyond import substitution in consumer goods.

Power, in an article written in the early sixties, had warned against exactly this difficulty of moving automatically from a strategy of consumer oriented import substitution to a more diversified expansion of industry. "There is no natural, spontaneous evolution from the kind of 'hot house' industrial growth induced by shutting out imports to this kind of permanent, self-sustained growth."[2]

However the government did not take any concrete measures to channelize investment into the production of capital goods, despite the emphasis on paper on the necessity to develop this sub-sector. In the words of the Second Plan: "Industrial policy must take into account and alleviate the present shortage of goods required to meet immediate needs, the ground must also be prepared now for production of all types of machinery, tools

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1 Guisinger (1977), p. 17.

2 Power (1963), p. 15.

Table 1.25

Anuual Rates of Growth for Manufacturing and its Principal Subsectors: West Pakistan 1963/64-1970/71

	1964/64-1070/71		1959/60-1964/65*	1964/65-1969/70*
Sectors	Current prices	Constan prices		
Consumer Goods	14.5	11.0		
Intermediate Goods	11.2	5.7		
Investment Goods	7.2	1.7		
Total Large-scale Manufacturing	12.9	9.0	16.9	10.1

Source: Growth rates for the period from 1963/64 are taken from S.Guisinger, "Patterns of Industrial Growth", Pakistan Development Review, 1977; growth rates for the periods from 1959/60-1964/65 and from 1964/65 to 1969/70 are taken from S.Haq, "Patterns of Industrialization in Pakistan", in E.A.G. Robinson and M.Kidron (eds.), Economic Development in South Asia, 1970.

*figures refer to Pakistan and are in 1959/60 constant prices.

Table 1.26

Structure of West Pakistan's Manufacturing Sector: 1970

Sector	Share in Value Added	Import as share of total supplies
	%	%
Consumer Goods	80	6
Intermediate Goods	7	58
Investment Goods	13	63

Source: S.Guisinger, "Patterns of Industrial Growth", Pakistan Development Review, 1977.

and equipments and of basic metals needed as raw materials for producer goods."[1]

The Third Plan stressed the importance of raising the level of investment and production in the capital goods sector in stronger terms. Thus one of the principal objectives of the plan was to "develop basic industries for the manufacture of producer goods so that the requirements of further industrialization can be met mainly from the country's own capacity."[2]

In practice nothing tangible was done to achieve a more diversified industrial structure. The differentiated tariff structure, initiated in the early fifties, gave greater protection to consumer goods relative to the production of intermediate and investment goods. The bias in tariff policy against investment goods became even more pronounced during the sixties. Moreover although it was claimed in plan documents that "the first important element in the strategy of industrialisation is to shift emphasis from consumer goods to capital goods industry",[4]

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1 The Second Plan (1960), p. 220.

2 The Third Plan (1965), p. 39.

3 Lewis (1969), p. 75.

4 Government of Pakistan, Planning Commission (1965), p. 447.

the public sector allocations to heavy industry were not only modest but the implementation was even more half-hearted. In the private sector, allocations under this head were meant to serve as rough guidelines the actual sanctions were determined by market priorities and profits. Thus in the Third Plan while the initial allocation for capital goods was nearly 30% of the planned expenditure on industry, this share was reduced to 20% in the revised estimates of spending following the cut in foreign aid. At the final stage, the proportion of actual investment in the capital goods sub-sector to total investment sanctioned to industry in the first four years of the plan was only 5.8%.[1]

The industrial structure at the end of the sixties was not only grossly lopsided but was also characterized by excess capacity and highly capital intensive techniques. These inefficiencies are widely agreed to be the result of the government policy of maintaining artificially low price of capital through measures such as cheap credit, overvalued currency etc.[2]

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1 Government of Pakistan, Planning Commission (1970), p. 35.

2 Soligo and Stern (1965); Islam (1967).

The highly inefficient industrialisation was achieved at a great social cost in terms of a tremendous increase in the concentration of resources in the sector. In the words of the Fourth Five Year Plan document: "the cost of development under this strategy for the private sector continued to rise. The cost is to be measured in terms of maldistribution of income in the economy, concentration of ownership and economic power and growing social tensions."[1] Evidence on the increased concentration of wealth in the industrial sector provided by the Chief Economist of the Planning Commission in 1968[2] revealed that twenty two families owned 80% of the banking business and 66% of the industrial assets of the country. The basis of Haq's estimates although never clearly specified, was supposed to be a report of a study group on monopolies in 1964. An alternate estimate based on data for 1970 also indicates a high degree of concentration though not as high as Haq's figures. According to the study, the twenty largest industrial families controlled 36% of all Pakistani manufacturing assets and more than half of all manufacturing assets listed on the stock exchange.[3] The monopoly power of this group was further buttressed by their control of three of the four largest banks in the country accounting for over three-fourths of total

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1 Fourth Plan (1970), p. 8.

2 Business Recorder (1968), p. 1.

3 White (1974), p. 65.

deposits.[1]

The inequities inherent in the development strategy had been anticipated by the planning body and had been justified as an inevitable cost of growth. The official view has been put forward by Haq, the then chief economist and a major proponent of the growth strategy, as follows: "Underdeveloped countries must consciously accept a philosophy of growth and shelve for the distant future all ideas of equitable distribution and welfare state. It should be recognized that these are luxiries which only developed countries can afford."[2] The basic premise of the strategy was that only by transferring income to the saving sector, in this case the industrialists and the rural elite, could the level of capital formation be raised to a level concomitant with development.

In this context public savings could only have a subsidiary role. The policy required that direct taxes be kept at low level so as not to dampen private initiative while the revenue needs of the government had to be met mainly through indirect taxes. The Second Plan document justified the openly regressive tax policy in terms of the objective of raising the rate of savings.

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1 Ibid., p. 74.

2 Haq (1963), p. 30.

"In order to achieve the high rate of marginal savings required for the plan reliance will be placed on indirect taxes, particularly consumption taxes which should capture a significant proportion of the increasing average incomes in the country...direct taxes cannot be made more progressive without affecting the incentive to work and save."[1]

The strategy, however failed in terms of it's own criteria since it did not succeed in achieving any significant acceleration in the rate of domestic savings. Gross domestic savings as a proportion of GNP increased from 8.5% in 1959/60 to 13.9% in 1962/63 (Table 1.24). Thereafter there was a steadily declining trend till 1968/69. Hence even during the early sixties while investment had increased appreciably the ratio of savings to GNP had been more or less stagnant at 12%. Even this low figure overstated the actual rate. As Griffin and Khan have pointed out the procedure of computing domestic savings as the difference between investment and foreign assistance, the latter being assessed at the artificially low official exchange rate, biased upwards the estimate of domestic savings.[2] Griffin has shown further that the annual private savings rate in directly productive activities was little more than 3.3% during the Second Plan.[3]

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1 Second Plan (1960), p. 49.

2 Griffin and Khan (1972), p. 192.

3 Griffin (1965), p. 43.

Hence the development strategy did not lead to either an industrial structure capable of providing the foundation for long term sustained growth or to an adequate level of savings, while the benefits of the higher income generated during the period have been mainly confined to the large landowners in the rural areas and the industrialists in the urban sector. Real wages of industrial workers were either stagnant or falling.[1] With respect to changes in the distribution of income, the available research does not provide any conclusive answers.[2] At any rate these studies are based on survey data which is known to substantially under-estimate the income of the upper income brackets. The use of income tax returns in conjunction with survey data to compensate for this under-representation of high income groups, still does not solve the problem of agricultural incomes and tax evasion.

Given this shortcoming, recent research on distributional questions based on survey data has been concerned with determining the changes in living standard of the poorest strata of society rather than a comparison of relative income changes between the higher and lower income groups. Naseem's study, the pioneering work on the measurement of poverty for Pakistan, confirms the expectation that the rapid growth in aggregate income during the sixties did not lead to any significant alleviation in the extent

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1 Khan (1967), p. 236; Hamid (1976), pp. 151-152.

2 Azfar (1973), pp. 43-69; Khandker (1973), pp. 70-100; Suleman (1973), pp. 101-118.

of poverty.[1] With respect to the rural sector, the results of the work are summarized as follows by the author: "About 25-40 per cent of the people in the 1960's - the decade of development - lived in abject poverty and another 25-30 per cent, perhaps, lived a little better, but not much above the subsistence level. As to the trends over time, our results say that the percentage, declined from 43.1 to 26.0; so did the absolute number of people living under conditions of abysmal poverty from 16.7 million in 1963/64 to 11.5 million in 1969/70. But if a little more liberal interpretation of poverty were given, then although the proportion of the poor in total population remained stable, the numbers increased from 23.46 million in 1963/64 to 26.51 million in 1969/70. These figures do vividly convey the extent of rural poverty in Pakistan".[2] The trend in poverty in the urban sector was roughly similar and was also very sensitive to the choice of a poverty line.[3] There was a reduction in the number of people falling below the poverty line in the early sixties followed by an increase in the incidence of poverty in the late sixties.

Evidence on changes in the agrarian structure provides

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1 Naseem (1973), p. 125.

2 Naseem (1973), pp. 125-126.

3 The poverty line denotes some minimum level of income required to cover basic needs such as housing, clothing as well as some minimum dietary intake.

further support to the thesis of a deterioration in the relative economic position of the poor strata in the rural sector. The structural changes in operational holdings during the sixties have been analysed in some recent studies[1] based on a comparison of the Agricultural Censuses of 1960 and 1972. The findings of the research show an increase in concentration of land use. Resumption of lands from tenants and renting in of land from small owners have been the main factors responsible for the increased skewedness of the distribution of operational holdings. The growing inequality in the access structure of land resources was manifested in the dramatic growth in the incidence of landlessness over the inter-censal period. It has been estimated, on the basis of Census data, that the number of landless households increased by 168%, with nearly 43% of the increase coming from other sectors of the rural population.[2] An alternative source places the estimated increase in landless labour households even higher at 384% raising the share of this group to nearly one-third of total rural households.[3]

Given the fact that the propertied classes in both the sectors were the main beneficiaries of Ayub's development

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1 Hussain (1980); Khan (1981); Naseem (1982).

2 Hussain (1980), p. 183.

3 Naseem (1982), p. 175.

program, there seems no valid basis for the suggestion[1] that the alliance between the landlords and the bourgeoisie was breaking down. It has been further claimed that the "disenchanged" landlords were joining the anti-government party, Bhutto's PPP, in large numbers towards the end of Ayub's era.[2] However as the above discussion has made clear the rural and urban elites were thriving under Ayub's regime. While the monopoly industrialists were reaping high profits the large landowners were gaining from the combined effect of technology, public subsidies and inadequate taxation. Government policies were channelizing resources to the upper stratum of the two sectors. There was no conflict between the leading classes as to who should bear the greater cost of growth. The burden of development, in terms of current deprivation, was borne by the underpriviledged sections of society.

Moreover, it has been pointed out[3] that policies during the period brought the ruling classes into closer links with each other and the civil-military oligarchy. Firstly, inter-marriages between these three powerful groups became very common. Secondly, members of the bureaucratic and military elite had acquired substantial lands under concessionary rates.

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1 Hussain (1980), p. 35.

2 Rashid (1978), p. 170.

3 Alam (1974), p. 18.

Thirdly, due to enhanced and tax free profits in agriculture, the urban industrialists invested part of their profit into acquisition of vast tracts of land for commercial farming or symbolic (status purposes).

Bhutto's rhetoric by highlighting the problems of income distribution and social justice further united the propertied classes by the threat against their priviledged position. Only member's of Bhutto's landlord faction in Sind and lesser known middle-sized landowners joined the PPP during the Anti-Ayub movement.[1] It was only after the election victory in 1970 that Punjab's feudal aristocracy joined the party in large numbers thereby continuing their tradition of supporting the government in power. "The elites cooperated with Ayub almost to a man -- as indeed they had with the Mughal, Sikh, British and pre-Ayub Pakistani regimes."[2]

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1 Lodhi (1980), p. 394.

2 Laporte (1975), p. 127.

CHAPTER II

POLITICAL ECONOMY OF THE BHUTTO PERIOD

The principal aim of this chapter is to evaluate major economic measures undertaken by the Bhutto government within a polotical economy framework. Towards this objective an attempt will be made to examine the class composition of the Bhutto regime and to see whether the ascendancy of the Peoples Party to power represented a change in the relative influence of the economically dominant classes of the large landowners and industrialists. The discussion will also assess to what extent shifts in the relative bargaining strength of the large farmers and industrialists were reflected in the direction of government policies pertaining to intersectoral distribution of resources. The scope of this chapter is limited to providing a brief overview of the link between economic decision making and the nature of the power relationships in the state during the seventies as a background to the more detailed analysis of the impact of these policies presented in subsequent chapters.

As has been discussed in greater detail in the preceding chapter, rapid economic growth achieved under Ayub's government had led to increasing income inequalities in the rural and urban sectors. Thus the industrial sector was characterized by a tremendous increase in the concentration of assets while

the real wages of industrial labour either declined or were stagnant. In agriculture the "green revolution resulted in rapid growth but also led to the deterioration of the relative position of the small farmers and tenants vis a vis the large farmers who were the main beneficiaries of the technological developments and the incentive stratety of the sixties. The perception by the large majority of the population that they had been deprived of any benefits of the much heralded economic progress in the sixties was a major factor sparking off the widespread dissatisfaction with the Ayub government which eventually culminated in its downfall.[1]

Bhutto was quick to sense the mood of the country and launched his campaign on the promise of sweeping economic and social reform. He offered the people a better standard of living, in terms of better housing, cheaper food and clothing, through direct addresses at mass rallies.[2]

This approach marked a significant departure from the traditional means of campaigning in the country whereby primary reliance was placed on gaining the political support of the landed elite who through their tremendous power and influence had control over the rural votes of their tenants as well as of small farmers.[3]

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1 For a detailed analysis of this and other factors in the movement against the military see Laporte (1975); Lodhi (1980); Burki (1980); Ali (1970).

2 Khan (1981), p. 171.

3 Alavi (1976), pp. 343-347.

In this environment little need was felt to establish direct contact with the masses. However it was only in the Punjab, where the large feudal landlords had chosen not to join the Peoples Party, that Bhutto relied on the mass mobilization method.[1] In Sind he relied on the conventional election strategy of forging alliances with landlords.[2]

The progesssive platform of Bhutto's party with its emphasis on a more equitable distribution of wealth, mationalization of industries, curbing of monopolies and agrarian reform attracted a diverse group of people. These included industrial, students, urban professionals, the rural poor and small farmers.[3] At the same time the party's radical stand did not preclude the entry of feudal landlords from Sind who were a part of Bhutto's faction.[4]

On the other hand the opposition parties continued to rely entirely on the landed elite to deliver the votes.[5] The feudal artistocracy of the Punjab belonged largely to the various factions of the Muslim League. Their campaign was based on obscure Islamic slogans skirting all issues of a socio-economic character.

Despite the fact that the largest landlords, the most influential of the rural elite, were represented in the opposition

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1 Lodhi (1980), p.394.

2 Ibid., p.203.

3 Burki (1980), pp. 45-48.

4 Lodhi (1980), p.203.

5 Sanderatne (1974), p.130; Burki (1980), p.55.

parties Bhutto won a resounding victory. Out of the 137 seats allocated to West Pakistan he won eighty-one.[1] The Peoples Party was specially successful in areas which had undergone rapid industrialization where it's campaign of socio-economic reforms mobilized support of urban groups like labour, middle class professionals, students and the poor strata.[2] In the rural constituencies the party by gaining the vote of the middle and small landowners managed to overcome the traditional voting pattern in the Punjab.[3] The rural elite won only nine out of the eighty-two seats allocated to the pronvince, "slumping to the lowest level ever."[4] The election results were hailed as marking the end of feudal social power. In the words of one observer "the December 1970 election was a disaster for the elites. With the exception of the districts along the Indus river i.e. the least developed districts, the rural families were trounced by all but unknown new entrants into the political system who campaigned under the banner of the Peoples Party and were attached to the coattails of Zulfiqar Ali Bhutto.....Even along the Indus in many cases the candidates who defeated Bhutto's men were not of the landed rural aristocracy but representatives of narrow sectarian religious groups. In a few cases renegade members of aristocratic families were successful as Peoples Party candidates."[5]

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1 Baxter (1971), p.221.

2 Ibid., p.214; Baxter and Burki (1975), pp. 924-925.

3 Frankel and Von Vorys (1972), pp.25-26.

4 Baxter (1974), p.25.

5 Laporte (1975), pp.127-128.

However other social scientists were more sceptical about the claims of a change in the political relationship in the countryside. It was felt[1] that the feudal influence was not as badly beaten as the results implied. Baxter[2] cites disunity among the landlord faction leading to a splitting of the opposition vote as the main reason for their poor showing in the elections. Whereas the PPP had won 61% of the seats it had only won one-third of the total votes cast in West Pakistan. In the Western districts the party won less votes than the combined votes of the opponents. The opposition party and independent candidates who won seats were mostly landlords. Also as Baxter points out the elite perform better in limited and controlled elections like Ayub's Basic Democracy system.[3] Finally Bhutto himself belonged to a very powerful landlord family in Sind and the feudals from his Sind faction were members of the Peoples Party since its inception in 1967. Concluding his study on feudal influence on Punjab politics, Baxter states: "One might conclude that the day of the rural elite control of government in the Punjab had ended but one caution must be noted only another election held on the lines of those in 1970 can determine the future of the landed aristocracy and whether the PPP has redeemed it's pledge to end feudal power in politics."[4]

In the next elections held in 1977 the leading Punjab families were well represented in the list of party nominees.

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1 Lodhi (1980), p.227; Baxter (1974), p.28.

2 Baxter (1974), p.28.

3 Baxter (1974), p.28.

4 Ibid.

By 1976, twenty eight out of the thirty three families listed by Baxter as having played a dominant role in Punjab politics since the beginning of the twentieth century had at least one member in the Peoples Party by 1976. The extent of the landlord domination of the party is further revealed by an examination of the class backgrounds of the top fifty leaders of the party chosen on the basis of importance of offices and political influence.[1] The results show that twenty seven out of the fifty belonged to the traditional landlord class.

The feudals after the setback of the '70 election started joining the PPP in large numbers with the primary objective of gaining access to policy makers and thereby the potential benefits of favourable government policies. The question, however, is why Bhutto after having changed the whole nature of campaigning fell back to the traditional means of eliciting support through alliances with landed notables? Why did he allow the erosion of the progressive image he had maintained in the pre-election phase by allowing the feudals to dominate the party machine?

It has been suggested that Bhutto was not averse to feudal support right from the beginning. "In the eyes of certain leftist radicals in the party, Bhutto was willing to curb capitalism but was somewhat averse to the idea of curbing landlordism unduly and particularly the influence of the landlords in politics."[2]

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1 Lodhi (1982), p.413.

2 Sayeed (1981), p.88.

His militant rhetoric was directed against monopoly capitalists. Capitalism not feudalism was viewed as an ally of imperialism. It was only after he failed to woo the Punjab landed aristocracy that he adopted the anti-feudal tone in his campaign speeches in the province to mobilize the support of the poor strata of rural society — the small peasants and landless labour. This was more a tactical response determined by the necessity of winning an electoral majority in the country side rather than an ideological commitment.[1] Even then he was careful not to alienate the support of his faction of Sindhi feudals. Thus despite his socialist stance his position on land ceiling was very vague and no exact limit was specified in the PPP manifesto.

Hence Bhutto had always envisaged the landlords as the major support base of his party. It was the feudals who had refused to join in the early phase. However once the Peoples Party was installed in power they flocked to it for opportunistic reasons. At the same time the PPP once in power found it increasingly difficult to control the expectations it had aroused in the mass component of it's social support. Bhutto, more than any politician before him,,relied on mass mobilization through direct appeals to the people to win an electoral majority. But he was always aware of the problems inherent in controlling mass movements once initiated in contrast to the more dependable and less volatile reservoir of support provided by the landed elite.[2]

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1 Lodhi (1980), p.394.

2 Lodhi (1980), p.389.

The expectations he had aroused during the election campaign did set off a momentum which was very difficult to control. The occupation of factories and land seizures continued after Bhutto came into power and after the announcement of the labour policy which fell short of the workers' expectations.[1] Finally the PPP government resorted to police and paramilitary forces to curb labour militancy. On October 1972 in a confrontation with the police forces fifteen workers were killed and four thousand arrested.[2] Ahmed has commented on the inevitability of the showdown between Bhutto and his major constituency in the following terms. "The repression was of course at variance with the posture but most assuredly not with the essence of social democracy especially in it's third workd variant, for, it is the essence of this social democracy that whenever the people's democratic movement directly threatens the existing class structure and or the (bourgeois) state the social democratic government must do whatever is necessary to preserve the essentials of the class structure and reassert the supremacy of the state."[3]

The adoption of tough measures against labour alienated the radical left[4] and led to the exit of two major representatives[5] of this group. It also signalled the beginning of the change

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1 Shaheed (1983), p.282.

2 Outlook, 4 November, 1972.

3 A. Ahmed (1978), p.486.

5 Even earlier during the election campaign differences with the leftist faction of the party had emerged over the question of setting a specific ceiling on landholdings and on the desirability of giving party tickets to the Sindhi landlords (Lodhi, 1980, p. 185).

6 Mukhtar Rana and Mairaj Mohammad Khan both of whom had strong links with labour unions.

in the class composition[1] of the party in favour of the landed elite. By the time of the party conference in 1972 the number of feudals in the party shot up significantly. The landed notables from Punjab's leading families now joined the party. The change in the class composition of the party is viewed by Ahmed as a necessary adjunct of the shift in party position from the pre-election phase to that of control of the government. He states that "changes in the internal class composition of the PPP were objectively determined by the changed position of the party in relation to the state. In other words the PPP had to be an apparatus predominantly of the radical petty bourgeoisie in the pre-election phase when the main objective was to secure a mass base and an electoral majority, particularly in the countryside. Once, however, the PPP had formed the government on the social democratic premise of seeking reform within the predicates of the state as already constituted, thereby becoming the political apparatus of the reactionary state, it's Left Wing was faced with the objective choice of either accepting the exigencies of the state or getting liquidated. In the event the Left was of course liquidated."[2]

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1 By 1974 various other members of the Left were purged from key positions in the party or the cabinet. Most notable among these was Mubashar Hasan who had been in charge of the crucial ministry of Finance, Planning and Economic Development. The only remaining representative of the Left in the cabinet was Sheikh Rashid who was assigned the ministry of agriculture (Burki, 1980, p.143.).

2 Ahmed (1978), p.481.

While Bhutto actively started to shift the balance of forces in favour of the landlords he also wanted to maintain his progressive image as the champion of the poor. The land reforms enacted in 1972, however, show that the desire to establish links with the Punjabi feudals was the stronger of the contending pressures. Hence despite the militancy of his rhetoric, Bhutto's land reforms stopped far short of a radical land distribution.[1] As a matter of fact certain features of his reforms[2] displayed a striking continuity with those of Ayub's reforms. The ceiling had to be set much lower to maintain political identity as a progressive and not to totally disillusion the constituency of the rural under-priviledged. Unlike his predecessor, Bhutto had depended on this stratum for political support and thereby had to make greater concession on paper, at least. Thus on the surfact there was a significant reduction in land ceilings from 500 to 150 acres for irrigated lands and from 1000 to 500 for unirrigated holdings. No compensation was to be paid for the land acquired which was to be distributed to poor peasants free of charge. Furthermore exemptions for orchards, stud farms etc., were no longer allowed.

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1 In his March 1972 address on land reforms Bhutto declared that "the reform will effectively break up the iniquitous concentration of landed wealth, reduce income disparities, increase production...".

However most observers felt that the reforms stopped far short of any serious attempt to break the concentration of land resources. See for example Herring (1980), pp. 605-607; Sanderatne (1974), p. 133; Alam (1974), p. 33.

2 The main provisions of the land reform are listed in the Economic Survey 1972-73, p. 10.

However in keeping with the earlier reforms the ceiling was applicable to individuals rather than family holdings. Alternate ceilings were set in terms of produce index units. As mentioned earlier these units greatly underestimated the current productivity of land. Exemptions for mechanized farming and allowances for inheritance were also defined in produce index units. It has been estimated that if full advantage is taken of various exemptions and transfers the effective ceiling was 932 irrigated acres in Sind and 1120 acres in the Punjab.[1] Estimates, from an alternative source, of irrigated land which could be retained by a family of five set the effective ceiling even higher with considerable variation across regions.[2]

Due to various loopholes and the fact that the largest landowners had distributed land as widely as possible after the '59 reform, a very small percentage of the landlords were actually affected by the ceiling legislation.[3] Out of declarants in the Punjab only 17% lost land. In Sind an even smaller proportion 10% of the landlords who declared lands were affected. Of the total area in holdings of 150 acres or more only 12% was resumed in the Punjab and 19% in Sind. Resumed area was 1% of the total area of 36.4 million acres in the Punjab and less than 3% of 11.4 million acres in Sind. Out of the total area of 567,499 acres resumed only 308,390 acres

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1 Khan (1981), p.177.

2 Sayeed (1981), p.92.

3 Figures quoted in this paragraph on the effect of the land reform have been estimated by Khan (1981, pp. 179-180.).

was alloted by fall 1978. The rest consisted mostly of uncultivated land. Finally it has been estimated that the maximum number of tenants who could have benefited from distribution of land was 73000, not more than 1% of the population of landless tenants and small owners.

The impact of the measure, although extremely limited, was still considerably greater than that of the earlier reforms. The area appropriated was about 60% higher, the area redistributed 46% higher and the number of households benefiting was double that under Ayub's reforms.[1]

Nevertheless the land reform of 1972 was very much in keeping with the tradition of going through the motions of land reform to maintain social legitimacy whereas a number of loopholes and exemptions ensured that the control of land resources remained largely unaffected. As an observer of Bhutto's reform has aptly commented: "Land reform as other agrarian measures was not intended to eradicate the feudals so much as to nudge them into the fold." They were "tempted to throwing their considerable weight behind the regime in order to protect their priviledges and ward off future perhaps more serious attempts at their eradication."[2]

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1 Naseem (1982), p. 196.

2 Herring (1980), p. 610.

Bhutto's land reforms indicated clearly that he wanted to maintain the priviledged position of the large landowners in the power structure. As an observer has noted. "Bhutto merely tinkered with the system in the countryside. In the process he consolidated the position of the landlord at the expense of the urban industrialist."[1] Bhutto's government while not introducing any radical change in the socio-economic structure did signify a shift in the power balance in favour of the land-owning classes.[2] On the other hand the industrialists who had been fostered by the development policies of the previous regime suffered a major setback. Although they never had been a part of the political elite, the monopoly industrialists exercised considerable pressure on government decision making through their contacts with the civil-military elite. With the ascendancy of the Peoples Party, they lost their contact with the government and their influence was considerably reduced.[3]

Even in the election period Bhutto, who was careful not to alienate any power bloc, saved his most militant rhetoric for the monopoly industrialists. Soon after coming into power he announced the nationalization of thirty one firms in ten basic industries.[4] The growing concentration of industrial assets had been the source of great public discontent with the Ayub

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1 Ali (1983), p. 105.

2 Gardezi and Rashid (1983), p.12; Ali (1983), p. 105.

3 Laporte (1975), p. 122.

4 These include iron and steel, basic metal, heavy engineering, heavy electrical machinery, assembly and manufacture of motor vehicles, tractor plants, heavy and basic chemical, petro-chemical industries (Economic Survey 1972/73, pp. 13-14.)

government. Domination of industry and finance by "22 families" had come to epitomize the disparities created by the regime's growth oriented policies. Curbing the economic power of the capitalist class was a major election promise of the Peoples Party. In this context nationalization had tremendous symbolic significance and was necessary to establish social legitimacy. In addition, widening the sphere of state activity was needed to develop a more balanced industrial sector on the one hand while providing a source of patronage in terms of jobs on the other. However, the nationalization program was certainly not aimed at social reorganization of production leading eventually to a complete socialization of the industrial sector. As noted by Sayeed: "One could see that the kind of socialism introduced under Bhutto was designed not so much to usher in a socialist society as it was to bring in state capitalism. State capitalism would obviously enhance the power of the Bonaparte and would not lead to any structural changes either in the economy or the society."[1]

Although the industrialists were given assurances of no further nationalization, they never quite recovered from the initial setback.[2] The industrial structure that had developed under Ayub's regime was economically and technically inefficient. High profits were made possible through various

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1 Sayeed (1981), p. 97.

2 Alavi (1983), p. 51; Burki (1980), p. 118; Sayeed (1981), p. 96.

fiscal and monetary concessions. The Bhutto regime removed most of these economic props such as the bonus voucher scheme, and various fiscal and monetary subsidies.[1]

Furthermore the position of the industrialists vis a vis labour weakened considerably during this period. Whereas under Ayub's military government union activity was kept under tight control, the bargaining power of labour, a major constituency of the Peoples Party, increased dramatically in the seventies. Industrial wages more than doubled between the period from 1970 to 1975 whereas the real wage index went up from 123 in 1970 to 160 in 1975.[2] The increase in the index over the five year period was greater than the change over the previous twenty years. It has been estimated that the increase in wages led to a tripling of labour costs between 1972 and 1977 for most factories.[3]

Industrial profits were further eroded by rising raw material costs attributable to the devaluation of the rupee and relatively higher prices of farm products. Domestic terms of trade moved sharply in favour of the farm sector during the seventies (see Table 3.1). The bottom fell out of the industrial sector which was used to a specially favourable environment created by public policy. Private

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1 Government of Pakistan, Finance Division, Budget in Brief 1972/73, pp. 34-37.

2 Guisinger and Hicks (1978), p. 1275.

3 World Bank (1978), p. 38.

Table 2.1

Private Industrial Investment in Current Prices 1969/70-1976/77 (million rupees)

	Large and Medium Scale	Small Scale	Total
1969/70	1208.2	187.7	1395.9
1970/71	1224.0	201.7	1425.7
1971/72	1016.3	219.1	1235.4
1972/73	763.1	255.9	1019.0
1973/74	697.3	325.5	1023.3
1974/75	990.4	446.5	1436.9
1975/76	1309.0	509.5	1818.5
1976/77	1209.7	585.3	1795.0

Source: Government of Pakistan, Economic Survey, 1978.

industrial investment fell sharply from Rs. 112.4 million in 1970/71 to Rs. 64.5 million in 1973/74 (see table 2.1.).

The bargaining strength of the landed elite was stronger in a system of parliamentary democracy where power stemmed from a spcial base. The greater power and influence of the landed elite under Bhutto's regime is borne out by the markedly pro-agricultural thrust of the policies undertaken during the period beginning with the devaluation of the rupee in 1972.[1] The move was seen as a major loss to the industrialists. Prior to this period Pakistan had a system of multiple exchange rates.[2] Exporters, mostly of agricultural commodities, received their earnings in terms of the official exchange rate. Manufacturers, on the other hand, were entitled to a more favourable exchange rate for their exports while they could import their machinery requirements at the cheap official rate. The devaluation removed this discrimination against agricultural commodities resulting in the increase in prices of farm goods which were not totally negated by the simultaneous increase in export taxes.

The nationalization of commercial banks[3] dealt a further blow to the monopoly houses. The close interconnection between the financial and industrial sector played an important

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1 Government of Pakistan, Finance Division, Economic Survey 1972/73, p. 17.

2 Government of Pakistan, Finance Division, Economic Survey 1972/73. p. 17.

3 Government of Pakistan, Finance Division, Economic Survey 1974/75, p. 83.

part in the growth of the industrial houses in the sixties.[1] During the Third Plan period the industrialists controlled 80% of the assets of commercial banks while credit institutions contributed nearly 50% of the industrial finance.[2] The nationalization gave the government significant control over investment priorities, creation and disbursement of credit in circulation. It enabled the government to not only use commercial banks for it's own deficit financing but to divert an increasing amount of bank credit to the farm sector.[3] The credit disbursed to agriculture shows a marked jump in the post nationalization period. Loans advanced by various organizations to agriculturists increased from Rs. 32.90 crores in 1972/73 to Rs. 108 crores in 1973/74 and Rs. 179 crores in 1976/77 while credit from commercial banks increased nearly threefold from Rs. 28 crores in 1972/73 to Rs. 80 crores in 1975/76 (Table 2.2).

Finally terms of trade moved sharply against industry reflecting, partly the impact of the devaluation of the rupee as well as the sharp increases in procurement prices during the period. Price incentives were a crucial ingredient[4] of the government strategy for agricultural development. As a matter of fact the approach to agrarian policy adopted by Bhutto's government essentially replicated the strategy followed by Ayub. The growth in agricultural output was to

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1 Amjad (1976), pp. 232-242.

2 Ibid., p. 235.

3 Ahmed (1978), p.492 ; Gardezi and Rashid (1983), p. 12.

4 Government of Pakistan, Planning Commission, Pricing Policy Packages 1972/73 to 1977/7 ; Government of Pakistan, Finance Division, Economic Survey, various issues.

Table 2.2

Loans Advanced to Farmers by Agricultural Development Bank (ADB) and Commercial Banks

(million rupees)

	ADB	Commercial Banks
1970/71	92.7	-
1971/72	80.0	-
1972/73	168.8	85.7
1973/74	415.2	286.4
1974/75	395.5	520.9
1975/76	532.2	808.1
1976/77	637.9	970.0
1977/78	429.8	1290.9

Source: Government of Pakistan, Ministry of Food, Agriculture, and Co-operatives, Agricultural Statistics of Pakistan 1978.

be achieved by a system of economic incentives within the given institutional framework. Hence the land reforms fell far short of any drastic land redistribution. The Peoples Party government opted for a continued reliance on a policy of price supports and input[1] subsidies despite the fact that the socio-economic milieu in the countryside this would inevitably lead to a further concentration of resources in the hands of the landed elite.

The policy with respect to mechanization was, once again, indicative of the extent to which the state was serving the interests of the upper strata of the rural sector notwithstanding the initial socialist rhetoric. The devaluation significantly increased tractorprices and kept imports at a low level the following year. In 1973/74 the government although not directly subsidizing tractor purchase undertook some measures[2] which made them more accessible and cheaper. Most important among these was the increased availability of credit from the Agricultural Development Bank (ADB) for purchase of tractors and other machinery at very favourable rates. ADB loans for tractors shot up from 430.65 million rupees in 1972/73 to Rs. 1800 million in the following year (Table 2.3.). Furthermore

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1 Ibid.

2 Government of Pakistan, Finance Division, Economic Survey 1974-75, p. 22.

Table 2.3

Agriculure Development Bank Loans-Itemwise Breakdown

(million rupees)

	1971/72	1972/73	1973/74	1974/75	1975/76*
Tractors	330.41	430.65	1800.30	1390.54	2200.40
Tubewells	180.41	260.42	510.33	860.67	-
Other Farm Needs	130.53	470.25	1230.46	830.38	-

Source: Government of Pakistan, Ministry of Food, Agriculture, and Co-operatives, Agricultural Statistics of Pakistan, 1978.

Table 2.4

Tractor Imports

	Total (number)
1970/71	4021
1971/72	3571
1972/73	2679
1973/74	5216
1974/75	7190
1975/76	10916
1976/77	15098
1977/78	15213

Source: Government of Pakistan, Ministry of Food, Agriculture, and Co-operatives, Agricultural Statistics of Pakistan, 1978.

Pakistanis living abroad were allowed to send tractors as gifts to relatives free of duty. Also, a number of government operated centres were set up to provide maintenance facilities at nominal charges. Finally a substantial subsidy was granted on diesel fuel used by tractors. The Agriculture Enquiry Committee Report, 1975,[1] ignoring the distributional implications of widespread mechanization recommended not only a further liberalization of import policy with respect to tractors but also their manufacture domestically. By 1976/77 annual import of tractors was reported at 15034 as compared to 7190 two years earlier. (Table 2.4.) The tremendous increase in tractors can also be assessed by the fact that the total number of tractors in the country in 1968 was 16500 as compared to annual imports of over fifteen thousand in the late seventies.

However, Bhutto enacted two reforms which marked a total break from the policies of previous governments. He imposed an agricultural income tax[2] for the first time in Pakistan's history and announced a second round of land reforms.[3] The '77 Reform reduced the ceiling from 150 acres to 100 acres for irrigated areas and from 300 acres to 200 acres for unirrigaged land. Compensation was to

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1 Government of Pakistan, Ministry of Food and Agriculture, 1975, p. 25.

2 Land Reform Act 1977, Pakistan Legal Decisions, Vol. 29, pp. 126-133.

3 Finance Supplementary Act, 1977, Pakistan Legal Decisions, Vol. 29, pp. 118-125.

to be paid for the surrendered land at the rate of Rs. 30 per PIU. Still there was a confiscatory element involved as the market price was much higher than the terms of compensation. These new land reforms according to one view "would have surely destroyed the basis of semi-feudal ownership in Pakistan."[1]

Herring, one the other hand, is far more sceptical of the impact of the ceiling legislation. On the basis of some preliminary calculations he concludes that even if the new law was effectively implemented very little cultivable land could be redistributed.[2] The loopholes in the legislation such as fixing the ceiling on a family rather than on an individual basis and in terms of produce index units as well as acres provided the landowners ample opportunities to get around the ceiling. In any case Bhutto's position on further reforms had been so ambiguous,[3] vacillating from assurances of no more reforms to statements implying future reductions in ceilings, that the landlords had already taken preventive action in terms of redistribution of land under various names.

The second major departure from previous policies was the imposition of an income tax on the agricultural sector.[4]

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1 Ahmed (1978), p. 489.

2 Herring (1980), p. 60.

3 Ibid,, pp. 607-608.

4 Finance Supplementary Act, 1977, Pakistan Legal Decisions, Vol. 29, pp. 118-125.

The land revenue system was abolished. All landholders with holdings up to 25 acres or less were entirely exempt from direct taxation. For the rest of the landowning population the rate of taxation applicable to agricultural income were the same as applied to the urban areas. However generous deductions were allowed for working capital and agricultural machinery. These various deductions provided considerable incentive for the modernization of agriculture. As an observer commented the feudals "were being nudged into the role of agrarian entrepreneurs."[1]

The timing of the announcement of the reforms just two months before the March elections is a clear indicator that Bhutto wanted to ensure the support of his rural constituency of the poorer strata of the sector. The exemption of landowners with holdings under 25 acres from payment of direct taxes would, according to Ahmed,[2] confer benefits to 91% of the country's peasantry owning over half of the cultivable area in Pakistan. Not to mention the fact that the decision removed the peasants from under the influence of the corrupt local revenue officers.

Even more important for political purposes was the symbolic impact of these reforms.[3] Bhutto's dramatic announcement was meant to regain the credibility of his

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1 Herring (1980), p. 608.

2 Ahmed (1978), p.489.

3 Khan (1981), pp. 183-184; Herring (1980), p. 607; Ahmed (1978), p.489.

image as the champion of the poor, downtrodden strata of society. The impact of the second round of land reforms on the rural poor is described by Ahmed. "The mere announcement of it in fact raised the aspiration of the peasantry, refurbished Bhutto's agrarian electoral base and provided for the militant peasants a platform for organising for the future."[1] Furthermore despite the deductions and exemptions allowed the agricultural income tax was considered a direct encroachment on the priviledges of the landed elite. Bhutto, himself, while discussing the details of his tax reform pointed out that the failure of earlier regimes to tax agriculture was due to their subservience to the powerful landlord lobby. In contrast he presented himself as above the influence of vested interest. "This measure is final proof that there is no question of your government giving preferential treatment to any vocation over another. We have no favourites. We see no reason why a zamindar should not contribute to public exchequer in the same way as a rich trader or an industrialist."[2]

The question arises as to why Bhutto by taking these steps, was going against the interests of the feudals who

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1 Ahmed (1978) p.498.

2 Pakistan Economist (1977), p. 4.

with full encouragement from him had come to dominate the political machine of the PPP. The answer to the question lies in Bhutto's approach to various power blocs in the society including the propertied classes. Social scientists have described his system of government as "Bonapartist" as well as "patrimonial." Sayeed applies Marx's concept of Bonapartism[1] to analyse the relationship between the dominant classes and the state in the following terms:

> By this is meant not just the rule of an arbitrary dictator but the rule of a leader who derived his power and authority from a well-established institution like the army in the case of Ayub, or from a political movement in the case of Bhutto. However the movement does not fully explain the nature of such a Bonapartist state. The effectiveness of such a state depends upon how the leader manipulates or brings under control certain institutions like the bureaucracy and the army and mobilizes and controls the economy and some of the nascent classes represented in it by altering or modifying the dominant modes of production like the capitalist mode in the case of industry and the feudal mode in the case of agriculture.[2]

While undermining the influence of various power groups the Bonaparte also confers benefits which are supposed to emanate directly from him as "the supreme benefactor." Although Sayeed classifies both the Ayub and Bhutto regimes as Bonapartist the state under Bhutto represents a more advanced form of Bonapartism displaying a greater autonomy from

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[1] Marx (1972), p. 106.

[2] Sayeed (1981), p. 109.

propertied interests and greater political control of institutions like the army and civil services.

Alternatively some social scientists like Lodhi[1] and Heeger[2] analyse the power structure of the Bhutto period in the framework of a patrimonial state. The main features of a patrimonial state are very similar to the Bonapartist model - the concentration of power, the personalized supervision over major power groups, the curtailment of their influence, and the delegation of benefits as an act of personal benovolence of the leader. The objective in each case is to create a personal dependency first, by weakening the various power blocs and then bringing them under control and protecting their interests. The discussion that follows is essentially a summary of Lodhi and Sayeed's account of Bhutto's dealings with the major power blocs.

Thus the influence of the military and civil services was weakened by a purge of some high ranking officials followed by structural reforms which further undermined their power. Reforms in the civil service included the withdrawal of constitutional guarantees safeguarding the rights of civil servants in office. Entry into the civil services was no longer limited to those who qualified in the competetive exams and age restrictions were also relaxed. These reforms not

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1 Lodhi (1980).

2 Heeger (1977).

only broke up the exclusiveness of the cadres but at the same time opened up further avenues of patronage in terms of administrative jobs as rewards for supporters. In the army he enacted changes which dispersed the power of the commander in over three or four high powered posts in the hope of avoiding another coup. In keeping with the description of the Bonapartist regime the weakening of the influence of these blocs was accompanied by the conferment of benefits. There was a substantial increase in expenditure on defence. By 1974/75 military spending comprised 55% of the budget allocations.

In the case of labour strong measures were taken to control strikes. Paramilitary forces such as the Federal Security Force were used to ruthlessly suppress labour militancy. However at the same time the labour policy of the government conferred considerable benefits to this class specially to workers in the nationalised sector. Also trade union membership increased very rapidly during this period in sharp contrast to earlier governments.

There was a dramatic showdown with the industrialists in the initial months of the PPP government. Immediately after coming into power passports belonging to the twenty leading industrial families were seized and two of the most prominent industrialists were placed under house arrest.

This news was followed by the announcement of the nationalization of basic industries. The nationalization of commercial banks further undermined the influence of this group. However, the initial show of strength was followed by some counciliatory moves. Arrested members were released and travel restrictions were lifted. The minister for finance and economic affairs and a chief proponent of the nationalization scheme, Mubashar Hasan, who was specially unpopular with the business community was removed from the cabinet. Moreover for the first time a member of the industrial elite was appointed in the prestiguous post of managing director of the national airlines. Despite these moves the relationship between the government and the business class remained tinged with mutual suspicion and hostility.

The most detailed treatment of the nature of the relationship between Bhutto and the landowning classes is provided in Lodhi's study.[1] It is pointed out that Bhutto actively sought the support of the landed elite right from the beginning of his period in power. The relationship with them, however, was not that of an equal ally. Thus "those who view Bhutto as representative of the landlord interests miss the point altogether. It was an asymetrical patron-client relationship. The landlord looked towards him for

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[1] Lodhi (1980), pp. 457-462.

protection (land reform measures and other favours) and they themselves with their patron-client network would provide building bloc in the countryside."[1] Parallel to his strategy with respect to other power blocs, he first undermined their independent influence through the enactment of land reforms. Thereby he created a situation where the landlords were vulnerable to his personal benevolence in the stringency with which the reforms were implemented.

The land reforms were the major instrument Bhutto used to make the landlords dependent on his favours. The relative leniency with which these reforms were implemented depended on the political loyalties of the landlord. The importance that was placed on this instrument as a means of bringing the rural elite under control can be assessed from the fact that files on land reform cases were kept in Bhutto's personal secretariat.[2] The landlords could save their lands only through Bhutto's personal intercession. Rewards for joining the Peoples Party meant that no action would be taken for concealed holdings. It was following the land reform regulation that the feudal aristocracy of the Punjab flocked to the Peoples Party.

Bhutto wanted to use the landowning class as a support

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1 Ibid,, p. 396.

2 Lodhi (1980), p. 458.

base but not to be dominated by them. Furthermore his reliance on feudal support did not preclude his attempt to woo the constituency of the smaller peasants and landless labour. A fact which is evident from the announcement of the second round of land reforms and the imposition of the income tax on agriculture. However once having asserted his position of power and independence from landed interests he was willing to grant them further benefits. There were enough loopholes in both legislations to ensure that loyal elements would still not be too badly off. According to Herring the '77 Reforms would hit hardest landowners of Baluchistan and NWFP, a group by and large hostile to the PPP government. Whereas the Sind and Punjabi landlords would be marginally affected. "The regionally skewed impact of the new ceiling offered potential to attack feudal political enemies in the two rebellious provinces while simultaneously avoiding serious confrontation with the politically important gentry of Punjab and Sind."[1] Furthermore there were other favours which would ensure that they would be well rewarded. These included input subsidies, credit at low rates of interest and higher prices for their products vis a vis manufactured goods, i.e. favourable terms of trade.

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[1] Herring (1980), p. 608.

CHAPTER III

MOVEMENTS IN THE INTERSECTORAL TERMS OF TRADE

Changes in the intersectoral terms of trade are among the most important determinants of the pace of growth and distribution in the economy. Thus a shift in terms of trade in favour of agriculture redistributes income to the sellers of agricultural output at the expense of urban and rural consumers of food and users of agricultural raw materials. This redistribution of income has important consequences for the growth performance of the economy. Changes in the relative price of farm output vis a vis manufactured goods not only influence the incentives to produce in the agricultural sector but also have repercussions on the rate of industrial expansion. A relatively faster rate of increase in the prices of farm products cuts into industrial profits directly through raising the cost of agricultural intermediate inputs and indirectly, higher prices of foodgrains, the basic wage good, generate pressure for increase in wages of industrial labour.

Movements in the intersectoral terms of trade can be caused by changes in the relative scarcities of sectoral outputs or may be the outcome of deliberate government policy. In early stages of development demand for food output grows rapidly under the combined impact of population growth and the high income elasticity of demand while supply is constrained by various techo-organisational bottlenecks. The resulting supply demand imbalance is reflected in the improvement of the sectoral price ratio facing agriculture.

Alternatively terms of trade can be manipulated through various government policies. Imposition of tariffs on manufactured goods purchased by agriculturists is one such method of tilting relative price ratio in favour of industry. Overvaluation of domestic currency can achieve the same objective where, as is usually the case, agriculture provides the bulk of exports while the major share of imports go to meet the requirements of the non-agricultural sector. Direct participation of the state in the market of farm products through export corporations or grain procurement programs is another means by which the government can influence the direction of changes in the domestic terms of trade.

Historically negative price policy by providing cheap food and raw materials played a crucial role in facilitating the initial stages of industrialization of a number of developed countries.[1] However recently the relationship between terms of trade and growth is being viewed from another perspective. The failure of agricultural output to keep pace with demand in most developing countries is attributed to the disincentive effect of unfavourable relative prices for the farm sector.[2] According to this view even if industry is the priority sector a positive price policy would be preferable to a negative one which is not capable of bringing forward adequate supplies of marketed surplus from agriculture, the basic requisite of a successful industrialization strategy. A positive shift in

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1 This point has been discussed in detail in the Introduction of this thesis

2 Proponents of this approach include Lipton (1977), Schultz (1978), Krishna (1967).

agriculture's terms of trade, it is argued, would lead to an increase in output and marketed supply providing incentives for a more intensive use of land, labour and modern inputs like fertilizer and high yielding varities of seed.

In the context of the Indian economy some economists[1] have blamed the inadequate growth of agricultural output and marketed surplus on the negative effects of deliberate government policy of maintaining unfavourable relative prices for agriculture. However statistical evidence provided by Thamarajikshi[2] for the period from 1951 to 1973 shows a secular trend in terms of trade in favour of the agricultural sector. In the same study a time series analysis of factors determining the marketable surplus of farm products points to output as the crucial variable while the impact of terms of trade is negligible and statistically insignificant. With regard to the responsiveness of aggregate output to prices, the findings indicate that increase in output was mainly determined by technology with the terms of trade effect again being unimportant.

The major work on the measurement of terms of trade for Pakistan has been done by Lewis and Hussain[3] for the period 1950-51 to 1964 and later updated by Lewis[4] up to 1970. Their estimates for Pakistan reveal a trend very similar to that found

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1 Mason (1966); Schultz (1964).

2 Thamarajikshi (1969); (1977).

3 Lewis and Hussain (1966).

4 Lewis (1970).

in India - a fall in agriculture's terms of trade till the mid fifties followed by an increasing trend tapering off in the late sixties. For the seventies, Gotsch and Brown[1] have further extended the Lewis series up to 1974/75. On the basis of their results, which will be discussed in greater detail later, the authors conclude that the overall trend in relative prices moved against the farm sector during the period.

The positive trend in agriculture's terms of trade in the sixties coincided with a breakthrough in agricultural production whereas the supposedly unfavourable shift in relative sectoral prices in the seventies was accompanied by a marked deceleration in the growth rate of farm output. This positive corelation between prices and farm output has been interpreted by some economists[2] as evidence of the sensitivity of agricultural production to changes in prices. Positive price incentives reflected in a favourable shift in agriculture's terms of trade are considered a major factor behind the high rates of agricultural growth achieved in the sixties while the subsequent stagnation of production in the seventies is attributed to the deterioration of the relative price ratio. It is argued further that the unfavourable turn in agriculture's terms of trade during the seventies was the result of government policy of maintaining artificially low prices of farm products.[3]

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1 Gotsch and Brown (1977).

2 Lewis and Hussain (1966), pp. 415-416; Bose and Clark (1966), pp. 273-308; Falcon and Gotsch (1966), pp. 25-26.

3 Brown (1978), p. 84; Gotsch and Brown (1977), p. 101.

Before assessing the relevance of the hypothesis of high supply responsiveness of agricultural production to price incentives, it is necessary to ascertain the direction of changes in the intersectoral terms of trade in the seventies. The Gotsch and Brown series covers only the period from 1969/70 to 1974/75 and is based on Lewis' methodology which, as will be discussed later, does not utilise the most efficient method of estimating the terms of trade index given the available data.

The main objective of this chapter is to provide a sounder empirical basis to the debate on sectoral price movements in the seventies by deriving a series of intersectoral terms of trade for the period from 1970 to 1977/78. The estimates presented in this study will not only cover a longer time period but will also be based on a more accurate methodology.

The analysis that follows is divided into three parts. Details on the methodology used to estimate the terms of trade series are provided in the first section. This is followed by an evaluation of the statistical results and their comparison with other available estimates for the seventies. The third section is concerned with tracing the implications of movements in terms of trade on the level and composition of farm output. An attempt is made to see to what extent the hypothesis of high supply responsiveness of farm output to changes in the sectoral price ratio is borne out by the experience of the agricultural sector in Pakistan. Finally, a statistical examination of the influence of economic variables such as supply demand factors on the

determination of price movements in the foodgrain section is presented in the appendix.

Methodology

Before proceeding to the problems of statistical measurement it would be useful to provide a rigorous definition of the various concepts of terms of trade generally referred to in development and foreign trade literature.[1] Broadly inter-sectoral terms of trade measure the ratio of exchange of commodities traded between sectors or countries.[2] Within this general definition several more specific concepts can be identified. The gross barter terms of trade (Q_x/Q_m) measure the ratio of the volume of exports of the sector to the volume of imports. Under the conditions when the balance of payment is balanced a fall in the gross barter terms of trade indicates an advantageous change for the exporting sector since a smaller quantity of exports is being exchanged for a larger amount of imports.

Net barter terms of trade (P_x/P_m), the most widely used measure, are defined as the ratio of the index of export prices of one sector/country to the index of import prices of the other

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1 See for instance Mieir (1968); pp 41-65; Kindleberger (1956).

2 More sophisticated measures of terms of trade have also been devised which relate not only to changes in the price and quantity of traded goods but also include the effect of productivity changes in the exporting sector (single factoral terms of trade) as well as both the exporting and importing sector (double factoral terms of trade) (Viner, 1937, pp 558-564).

sector/country (P_x/P_m). This measure shows a favourable/unfavourable shift if the price level of exports has increased/decreased relative to the price level of imports. Improvement in the net barter terms of trade indicates an increase in the purchasing power of a unit of exports, which in the absence of any dramatic change in efficiency in the two sectors or in the quantity and composition of traded goods, can be taken to imply a transfer of income from the importing to the exporting sector.

Finally the income terms of trade incorporate the effect of changes in the volume of the sector's exports as well as prices and are defined as the ratio of the value index of exports to the price of imports (P_xQ_x/P_m). To the extent that an increase/decrease in the price of exports is accompanied by a proportionately greater fall/rise in the volume of exports, the income terms of trade would be a more accurate index than the net barter terms of trade of the relative change in the purchasing power of the exporting sector.

Lack of adequate data on the time series of marketed farm output has precluded any attempts to measure income terms of trade for the Pakistan economy. However, as mentioned earlier, estimates of net barter terms of trade have been provided by Lewis and Hussain[1] and by Lewis[2] covering the period from 1950/51 to 1970. More recently Gotsch and Brown[3] have used Lewis

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1 Lewis and Hussain (1966).

2 Lewis (1970).

3 Gotsch and Brown (1977).

methodology to extend the series up to the mid-seventies.

The main problem in the construction of a terms of trade index is related to the choice of appropriate prices and weights. Ideally all major items traded between sectors should be included in the index. Prices used should reflect the prices received and prices paid by the agriculturist for the sale of his products and the purchase of non-agricultural commodities respectively. Furthermore the price of each commodity should be weighted by the quantities bought from or sold to the non-agricultural sector.

Data on intersectoral transactions is not available for the Pakistan economy therefore weights have to be computed by some indirect method. Lewis derived the value of intersectoral sales and purchases by estimating the total availability of various commodities and then apportioning it between the agricultural and non-agricultural sector on the basis of certain assumptions about the consumption pattern of the two sectors. The net availability of each commodity was calculated by adding the value of imports to the value of domestic supply less the value of exports. Alternative sets of weights were derived on the basis of different assumptions about consumption behaviour of the population of the two sectors (these included equal per capita expenditure in the sectors; 10%, 25% amd 40% less per capita expenditure on non-agricultural consumption goods in the rural sector). Similarly for manufactured intermediate

and investment goods a smaller per capita share was assigned to the agricultural sector but the exact proportions were not specified.

Apart from the fact that the value of intersectoral sales and purchases was based on arbitrary assumptions, the accuracy of Lewis weighting scheme was further reduced by the inclusion of commodities in the index which did not enter in the trade between sectors. All commodities produced in the large scale manufacturing sector were incorporated in the composite index of non-agricultural items. Weights were assigned to items like basic metals, non metallic minerals which were hardly likely to feature in the purchases of farmers from the non-agricultural sector. Thus the weight of machinery except electrical was greater than the combined share of tea, sugar and edible oils while the share of basic metals in the weighting scheme was larger than that of sugar (see Table A.2). Furthermore commodities purchased from the non-agricultural sector but not produced by large scale industry such as expenditure on electricity and gas were excluced.

Information available on per capita consumption expenditure in the rural and urban sectors makes it possible to estimate more accurate weights by employing an alternate methodology used by Thamarajikshi[1] in her study on sectoral prices in India. Using

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1 Thamarajikshi (1969).

this method, an attempt is made to generate a time series of net barter terms of trade for the period from 1969/70 to 1978/79.

The construction of weights for consumption goods by this method entails the following steps:

1. The Household Income and Expenditure Survey published by Central Statistical Office (CSO) gives the pattern of monthly consumption expenditure per household for both urban and rural areas classified by major items of food, clothing, footwear, fuel and lighting and other miscellaneous expenditure. The sub-division of these items into agricultural and non-agricultural commodities is as follows:

Agricultural[1]	Non-agricultural
1. Foodgrains	1. Edible Oils
2. Pulses	2. Condiments and spices
3. Milk and milk products	3. Sugar and sugar products
4. Meat and fish	4. Tobacco and chewing products
5. Poultry	5. Tea
6. Vegetables	6. Clothing and footwear
7. Firewood	7. Gas and electricity

2. The next step is to derive total expenditure on purchases

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[1] The agricultural sector is defined to include crop rearing, fishing, livestock and forestry.

and sales of various commodities by the agricultural and non-agricultural sector by using sectoral population data to blow up per capita expenditure on individual items.

Thamarajikshi[1] in her study assumed that the rural pattern of consumption applied to the agricultural population and the less organised sub-sectors of non-agriculture (i.e. forestry, fishery, small enterprises and construction), whereas the urban pattern applied to the rest of the non-agricultural sector. Mundle[2] has derived a simple method which does away with the need to rely on assumption on consumption patterns to estimate expenditure on agricultural and non-agricultural goods by the agricultural and non-agricultural population. He simply decomposes the rural and urban population into their agricultural and non-agricultural components. Hence the value of sales of individual agricultural products to non-agriculture is obtained by multiplying the per capita expenditure on each item in the rural and urban areas by the rural non-agricultural and urban non-agricultural populations respectively and summing the totals. A similar procedure is applied to derive the value of purchases of non-agricultural products by the agricultural sector.

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1 Thamarajikshi (1969).

2 Mundle (1975).

For Pakistan, although information is not available on the division of population by different economic categories, the Labour Force Survey published by the CSO provides data on self supporting persons in various economic categories as a proportion of the rural and urban totals. This information can be used to estimate agricultural and non-agricultural population in the two sectors on the assumption that population is distributed in different economic categories in the same ratio as self supporting persons. Estimates of urban and rural population for 1969/70 have been taken from a World Bank Report.[1]

3. Usually household survey totals when blown up are less than the national accounts total of private consumption expenditure.[2] The estimate of total private consumption expenditure based on survey data is 82% of the national income estimates of the corresponding figure. The lower value of consumption estimates may be partly due to the inadequate representation of the higher income groups in the sample.[3] Furthermore the national account consumption figure also included consumptions of various non-profit organisations such as religious institutions, private schools, private hospitals and co-operatives etc.

To adjust the the discrepancy in the two estimates, the ratio of expenditure on individual items to the total consumer

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1 World Bank (1978), Appendix Table 1.3, p.152

2 Oshima (1970), p.16

3 This inadequacy of the survey data has been pointed out by Azfar (1973), p.47; Naseem(1973), p. 120

expenditure based on survey data is applied to the consumption expenditure given by the National Income statistics.[1]

4. Imports are deducted from the adjusted estimates to derive final values to be used as weights. Following the approach adopted by Thamarajikshi, imports of non-agricultural commodities are assumed to be divided between the two sectors in proportion to their share in total consumption whereas agricultural commodities for final use are assumed to be imported only for the consumption of the non-agricultural sector. Detailed data on imports by commodities was available from the Statistical Bulletin published by the CSO.

With respect to agricultural commodities for intermediate use it is assumed that the entire value of production is purchased by non-agriculture. No allowance has been made for seed and wastage. Exports are not deducted on the assumption that agricultural raw materials exported come to the non-agricultural sector. Data on value of production of agricultural intermediate products is provided in the National Income Accounts published by the CSO. This publication also provides information on the value of non-agricultural intermediate inputs used by agriculture such as fertilizers, pesticides, water charges etc. Data on electricity and diesel oil used for farm production is given in the Energy

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1 Here it should be mentioned that in the national accounts figures private consumption expenditure is not an independent estimate but is derived as a residual of NNP at factor cost after making adjustment for all other flows and hence includes an indeterminate statistical discrepancy.

Year Book of 1979.[1]

The index was assigned base year weights in accordance with the Laspeyre formula. Base year weights were considered appropriate as the period of time was short enough for there not to have been any major shifts in the composition of sectoral trade. The choice of 1969/70 as base year was guided by several considerations. Firstly it was a relatively normal year in a period characterized by wide fluctuations in prices. Prices had stabilized after the sharp increases in the drought years of 1966/67 and 1967/68. While 1970/71 was characterized by somewhat lower prices due to the record breaking harvest of the preceding year. Finally a new series of wholesale price index numbers was provided by the CSO with 1969/70 as base period which had wider coverage and more detailed classification of commodities.

Wholesale prices were used in the construction of terms of trade indices. More appropriate prices would have been harvest prices at which the farmers sells his product and retail prices which he pays for purchases from the non-agricultural sector. However in the case of Pakistan, the harvest prices used by the Central Statistical Office are a fixed proportion of wholesale prices and are not an independent measure.[2] Wholesale prices are also believed to be more reliable than retail prices since fewer outlets are involved.

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1 Government of Pakistan (1979).

2 Government of Pakistan, Statistics Division (1977), p. (i).

Statistical Results

Estimates of terms of trade, based on the alternate method, for final goods, intermediate goods and all commodities traded are presented in Table3.1. The results for the overall index of terms of trade reveal a shift in favour of the agricultural sector. Terms of trade at a more disaggregated level in the case of commodities for final and intermediate use also point to a greater rate of increase in farm prices as compared to those for non-agricultural goods. The improvement in agriculture's terms of trade was most pronounced in the case of intermediate goods. Whereas net barter terms of trade for all commodities moved from 103.31 in 1970/71 to 112.7 in 1978/79, the change was more dramatic in the case of intermediate goods with the index increasing by nearly 50% from 107.19 in 1970/71 to 157.54 in 1977/78.

The faster growth in the relative price ratio for the intermediate goods sector was not attributable to differences in the rate of price increase within the agricultural sector between consumption and intermediate goods. On the contrary the rate of increase of the price index for agricultural products for final use was 16% while the corresponding figure for agricultural commodities for intermediate use was lower at 14.9%(see Table 3.4 The greater improvement in agriculture's terms of trade for intermediate goods reflected the slow rate of price increase of

Table 3.1

Agriculture's Terms of Trade - Alternate Method
Base 1969/1970

	Final goods	Intermediate goods	Final and Intermediate goods
1970/71	101.7	107.19	103.3
1971/72	101.4	110.7	103.3
1972/73	104.0	144.63	110.6
1973/74	113.0	142.30	114.3
1974/75	107.3	115.92	103.3
1975/76	110.6	125.49	109.1
1976/77	110.1	145.79	110.1
1977/78	107.2	157.84	108.7
1978/79	108.8	152.58	112.7

Table 3.2

Index of Prices Received by Agriculture-Alternate Method
Base 1969/70

	Final goods	Intermediate goods	Final and Intermediate goods
1970/71	108.48	112.34	109.11
1971/72	114.08	117.34	114.04
1972/73	127.82	143.48	132.48
1973/74	192.58	187.66	188.2
1974/75	238.78	199.7	218.45
1975/76	256.43	233.91	240.35
1976/77	285.88	265.92	272.45
1977/78	305.92	289.95	294.21
1978/79	317.13	332.16	313.38

Table 3.3

Index of Prices Received by Non-Agriculture-Alternate Method
Base 1960/70

	Final goods	Intermediate goods	Final and Intermediate goods
1970/71	106.7	104.8	106.5
1971/72	112.5	106	111.86
1972/73	122.86	99.2	120.8
1973/74	170.4	131.87	167.07
1974/75	222.6	172.27	218.51
1975/76	231.8	186.4	228.36
1976/77	259.77	182.4	253.36
1977/78	285.46	183.7	276.59
1978/79	291.43	217.7	285.31

Table 3.4

Compound Rates of Growth of Indices based on Alternate Method

Agriculture

Prices received for final goods.	16.0%
Prices received for intermediate goods.	14.9%
Prices received for final and intermediate goods.	15.7%

Non-Agriculture

Prices received for final goods.	14.8%
prices received for intermediate goods.	10.0%
Prices received for final and intermediate goods.	14.5%

Net Barter Terms of Trade

Goods for final use.	1.0%
Goods for Intermediate use.	4.5%
Goods for final and Intermediate use.	0.9%

non-agricultural intermediate inputs. Non-farm intermediate products registered the lowest rate of price increase of only 10% as compared to 14.8% for non-agricultural consumption commodities. The below average increase in the price of fertilizers which comprised nearly one-third of non-agricultural inputs purchased by the farm sector was a major reason for the relatively slower rising trend of prices in the subsector (see Table A.5).

Trends in growth rates hide the wide fluctuations in prices which marked the period specially the years from 1972 to 1975. The favourable shift in agriculture's terms of trade in 1972/73 was largely a result of the dramatic price increase in the export crops (rice, cotton) following the devaluation of the rupee in May 1972 and the inflation in international prices of primary commodities (see Tables A.4 and A.5). Prices of non-traded crops were unaffected - wheat prices increased by a mere 3%. Inflationary pressures in the economy reached a peak in 1973/74, prices of non-agricultural

products increased by 38% over the previous year while the corresponding figure for the agricultural sector was even higher at 50% and was reflected in a further jump in the terms of trade for the farm sector. This time the main impetus for higher prices came from the final goods component of agriculture. The following year, 1974/75, agriculture's terms of trade declined sharply as a result of a slump in the international price of cotton. The terms of trade for intermediate goods dropped by nearly thirty points from 142.30 to 115.92. The deterioration in terms of trade in the final goods sector was not so drastic and foodgrain prices continued to show substantial increase over the previous years - 54% in the case of wheat, 90% in the case of maize, and 118% in the case of bajra. The latter half of the seventies was marked by a considerable reduction in the rate of inflation in the economy. However terms of trade continued to move in favour of agriculture due to a steady increase in the price of products for intermediate use mainly cotton.

Comparisons with the Gotsch and Brown Estimates

The results of a continued favourable trend in agriculture's terms of trade during the seventies go contrary to the findings of the only other empirical work on sectoral price trends for the period. The estimates derived by Gotsch and Brown,[1] based on

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1 The estimates derived by Gotsch and Brown are presented in graph form only.

Lewis weights, reveal a sharp increase in the terms of trade index up to 1973/74 followed by a sharp decline in 1974/75. On the basis of these findings the authors claim that there was a "steep decline in the terms of trade ratio in the post '68 period.[1]

The diametrically opposite conclusion to the results derived earlier in this chapter is simply attributable to the fact that the Gotsch and Brown series extends only up to 1974/5, a year marked by a sharp downward fluctuation in the sectoral price ratio facing agriculture. A further extension of Lewis series up to 1978/79 has been computed in this study and is presented in Table 3.5. The estimates bring out clearly that the fall in terms of trade in 1974/75 was not the beginning of a declining trend but rather fluctuations around an increasing trend.

The cause of the slump in the terms of trade was a clear indicator of it's transitory nature. Gotsch and Brown attributed the drop in relative prices to a sharp increase in the prices of manufactured consumer goods but although the prices of these commodities were rising they were not responsible for the downward movement in the terms of trade. This is clear from the fact that estimates of terms of trade for consumption goods based on Lewis weights (Table 3.5) show an improvement rather than a fall. Hence the index for this sub-sector rose from

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1 Gotsch and Brown (1977) p. 39.

Table 3.5

Agriculture's Terms of Trade-Lewis Weights
Base 1969/70

	Final goods	Intermediate goods	Final and Intermediate goods
1979/71	98.87	106.06	101.38
1971/72	98.75	103.96	100.5
1972/73	104.17	126.78	112.43
1973/74	102.36	128.32	111.6
1974/75	107.44	104.94	106.43
1975/76	108.08	115.31	110.62
1976/77	106.19	133.85	115.72
1977/78	102.37	143.16	115.58
1978/79	103.26	158.12	121.24

Table 3.6

Index of Prices Received by Agriculture-Lewis weights
Base 1969/70

	Final goods	Intermediate goods	Final and Intermediate goods
1979/71	105.28	111.57	107.41
1971/72	112.81	116.67	113.97
1972/73	130.46	147.55	136.71
1973/74	177.06	192.4	182.48
1974/75	228.87	202.47	217.94
1975/76	242.15	236.06	239.06
1976/77	267.85	269.43	267.66
1977/78	290.84	290.52	289.84
1978/79	297.77	337.86	312.43

Table 3.7

Index Prices Received by Non-Agriculture-Lewis weights
Base 1969/70

	Final goods	Intermediate goods	Final and Intermediate goods
1970/71	106.48	105.19	105.95
1971/72	114.23	112.22	113.4
1972/73	125.24	116.38	121.6
1973/74	172.97	149.94	163.51
1974/75	213.01	192.94	204.77
1975/76	224.04	204.72	216.11
1976/77	252.23	201.28	231.3
1977/78	284.11	202.94	250.77
1978/79	288.37	213.67	257.69

Table 3.8

Compound Rates of Growth of Indices Based on Lewis weights
Base 1969/70

<u>Agriculture</u>	
Prices received for final Goods	15.2%
Prices received for Intermediate Goods	15.2%
Prices received for all Commodities	15.2%
<u>Non-Agriculture</u>	
Prices received for final Goods	14.5%
Prices received for Intermediate Goods	10.4%
Prices received for Final and Intermediate Goods	12.9%
<u>Net Barter Terms of Trade</u>	
Goods for Final use	6.0%
Goods for Intermediate use	4.3%
Goods for Final and Intermediate use	1.9%

102.36 in 1973/74 to 107.44 in 1974/75 while the overall index based on Lewis weights fell from 111.6 to 106.4 in 1974/75. A disaggregated analysis of prices reveals that the deterioration was a result of the sharp fall in cotton prices due to a recession in international demand.

Net barter terms of trade derived on the basis of Lewis weights show an even faster rate of increase than the series estimated by the alternate method. Thus from 1970/71 to 1978/79 the Lewis series grew at an annual rate of 1.9% which was more than double the trend computed for the alternate series (Table 3.10). The difference in the rate of change in the two sets of terms of trade series reflects the differences in the weights used. Whereas the weights used for agricultural commodities are roughly comparable, there are considerable divergences between the two sets of weights used to compute the price index of non-agricultural commodities purchased by agriculture. Intermediate manufactured goods, which registered the lowest rate of price increase for the period, comprise 50% of total purchases in the Lewis scheme while their share is only 9.3% in the weights for non-agricultural goods derived by the alternate method (see Table A.2). Thus while the index of prices of agricultural commodities revealed a fairly similar trend for both methods, the rate of increase in the index of prices received by non-agriculture was much lower for the Lewis series at 12.9% as compared to 14.5% for the alternate series

Trends and Phases in Movement of Terms of Trade - 1950/51 to 1978/79

Estimates of terms of trade by Lewis and Hussain[1] and by Lewis[2] for the period from 1951 to 1969 and the further extension of the series up to 1978/79, computed in this study, provide a time series over the longest period. This data can be used to establish trends and trace out the different phases in the movements of the sectoral price ratio.

As can be seen from Table 3.9 the first phase from 1951/52 to 1954/55 is marked by a decline in prices of farm vis a vis non-agricultural goods. This is followed by a period of continuous improvement in terms of trade in favour of agriculture from the mid-fifties to 1967/68 tapering off till 1970/71. The final phase till the late seventies is characterised by wide fluctuations in the series along a sharply increasing trend.

Annual growth rate for the price indices of agricultural products, non-agricultural products and net barter terms of trade for the period from 1958 to 1969 and from 1969/70 to 1978/79 as well as for the entire period are presented in Table 3.10. The results reveal a much higher level of price increase in the inflationary situation in the seventies compared to the relative price stability of the sixties. Although agriculture's net barter terms of trade registered a positive trend in both periods,

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1 Lewis & Hussain (1966).

2 Lewis (1970).

Table 3.9

Intersectoral Terms of Trade 1951-1978
(3 Year moving average) Base 1959/60

1951-54	97.39
1952-55	91.14
1953-56	87.36
1954-57	91.41
1955-58	96.03
1956-59	98.76
1957-60	99.43
1958-61	103.13
1959-62	106.39
1960-63	108.28
1961-69	107.17
1962-65	109.15
1963-66	110.01
1964-67	112.10
1965-68	108.46
1966-69	106.55
1969-70	103.2
1968-71	104.0
1969-72	104.9
1970-73	109.8
1971-74	118.2
1972-75	121.8
1973-76	118.6
1974-77	115.5
1975-78	118.0

Source: 1951/54 to 1960/63 from Lewis and Hussain (1967);
1961/64 to 1966/69 from Lewis (1970)
1969/70 to 1977/78 calculated in this thesis;
Weights were taken from Lewis and Hussain(1966);
data on price indices taken from Government of Pakistan, central Statistical Office, Statistical Bulletin, 1978/79.

Table 3.10

Compound Rates of Growth
Indices based on Lewis' Weights, 1958-1978
(3 years moving avarage)
1959/60 = 100

	58/61-75/78	58/61-66/69	69/70-75/7
Prices received by Agriculture	12.0%	2.4%	14.6%
Prices received by Non-Agriculture	8.04%	1.7%	12.3%
Terms of Trade	4.19%	.9%	2.0%

the annual growth rate at 2% in the latter period was more than double the trend prevailing in the years form 1958 to 1969.

Implications of Shifts in Terms of Trade on Output

In the absence of time series data on marketable surplus, a rigorous test of the response of marketed surplus to changes in the terms of trade has not been possible for the Pakistan economy. However cross-sectional studies by Khan and Chaudhury[1] and Raqibuzzaman[2] based on National Sample Survey data for 1959 and 1960 respectively have statistically tested the response of marketed output to various economic variables. The results of both studies indicate that the principal determinant of marketed surplus is total output. In each case the elasticity of marketed output with respect to output was greater than unity reflecting the strong positive association between the two variables.

Evidence on the responsiveness of output to prices is mainly limited to single crops.[3] The findings show a positive supply response to changes in relative prices, the degree of output elasticity to price being greater for cash crops. However these results cannot be generalized to indicate the response of aggregate output to the level of intersectoral terms of trade. Given the scarcity of land resources, improvements in productivity per acre is an essential prerequisite to an increase in overall farm output. Thus although price incentives may induce a shift of acreage from one crop to another, they may be ineffective in raising aggregate output where

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1 Khan and Chaudhury (1963).

2 Raqibuzzaman (1966).

3 Cummings (1975), Falcon (1964).

productivity per acre is constrained at low levels due to technological and organizational bottlenecks.

Despite these considerations, a number of studies on agricultural development in Pakistan assume a strong positive association between farm prices and sectoral output.[1] The tendency to singling out price incentives as the major catalyst for the expansion of agricultural output gained popularity in the sixties when favourable movements in agriculture's terms of trade coincided with substantial improvements in farm productivity. Lewis[2] interpreted the positive association between prices and output during the period as evidence of a casual link with higher prices leading to increased output. No mechamism was specified as to how price incentives led to a major breakthrough in aggregate output. By shifting the emphasis to prices as the major determinant of production he undermined the importance of technological and structural factors underlying low productivity.

The dramatic growth in farm output in the sixties was preceded by a considerable easing of the irrigation constraint as a result of the widespread installation of tubwells.[3] Regular availability and seasonal flexibility of water supply made possible by tubewell irrigation, set the stage for the adoption of the seed-fertilizer technology. In the absence of an improvement in

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1 Lewis and Hussain (1966), p. 415-416; Lieftinck, Sadove and Creyke (1968), pp. 10-11; Bose and Clark (1969), pp. 273-30; Falcon and Gotsch (1966),pp. 25-26.

2 Lewis and Hussain (1966), p. 415-416.

3 Mohammed (1965).

water availability, the increase in output was not forthcoming. Terms of trade moved in favour of agriculture in the late fifties yet their effect on output was limited before the spread of tubewell irrigation. Moreover positive price policies did not produce a "green revolution" in East Pakistan due to a variety of infra-structural obstacles. As Bose in his study on the contrast in agricultural development in East and West Pakistan has pointed out: "the main factors limiting the programme of increased uses of improved inputs have been the size and quality of the extension sources, financial inability of most farmers to purchase these inputs, and the risks of crop failures due to natural calamities. These obstacles cannot be eliminated by price incentives."[1]

The ability to respond to prices was a function of the increased and timely availability of water. At the same time the productive potential of tubewell technology was so great that the incentive effect of prices was marginal by comparison. Nulty[2] has estimated that a 20% fall in prices of rice, maize, sugarcane and wheat would reduce the advantage of a tubewell farm as compared to a non-tubewell farm from a 60%-80% increase to a 50-70% increase in net income.

The results of the only attempt to estimate the relationship between terms of trade changes and aggregate output for the

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1 Bose (1972), p.92.

2 Nulty (1972), p.92.

Pakistan economy during the sixties show that the effect of prices on output was statistically insignificant. However the regression of output on the time variable, a proxy for technological change, was highly significant. On the basis of these results the authors concluded that "the general profitability of agriculture and the obvious fact that in the Pakistan case the productivity of improved technology was sufficient to provide the incentive necessary for a respectable rate of growth".[1]

After the initial impact of the new technology had run through, continued favourable movements in the terms of trade in the seventies were associated with relative stagnation in aggregate output. The government policy of enhancing procurement prices of major crops did lead to significant gains in the output of wheat, rice and sugarcane. However this was achieved largely through shifts in acreage away from inferior cereals and pulses, product outside the purview of the procurement program. The yields of major crops, with the exception of wheat, were either stagnant or declining. Rice yields showed no improvement while output per acre for sugarcane and cotton revealed a falling trend. Increased production of these crops was almost entirely attributable to shifts in acreage. A more detailed empirical analysis of the pattern and sources of agricultural growth in the seventies is presented in a later chapter, the brief mention in the present context was merely to illustrate the ineffectiveness of the policy of relying on price incentives in raising the level of aggregate output.

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1 Gotsch and Brown (1977), p. 39.

APPENDIX : A

Determinants of Foodgrain Prices 1961/62 - 1976/77

An attempt is made in this section to statistically test the influence of economic variable such as net availability of foodgrains and money supply on foodgrain prices by fitting a multiple regression equation of the following form:[1]

$$P_t = a + b(D-S)_{t-1} + c(D-S)_{t-2} + M_t$$

D-S is the gap between aggregate demand and supply measured from a base period in this case, 1959/60, when the two are assumed to be balanced.

The Demand variable (D) incorporates the effect of changes over time in per capita income and population and is measured by the following equation:

$$D_t = L_t(Q(1+\hat{\Delta}Y/Y)^b)_t$$

where L_t is population in period t

Q is per capita consumption of foodgrains in base period

Y is per capita income over base period level

$\hat{\Delta}Y$ is change in per capita income over base period level

b is the income elasticity of demand for foodgrains

Alternate values for aggregate demand (D) were calculated

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[1] This model was used by Mellor and Dar (1968) in their study on foodgrain prices in the Indian economy from 1949 to 1964.

on the basis of three sets of figures for b. Estimates of income elasticity of foodgrains vary from .33[1] to an alternate value of .22[2]. While FAO studies[3] use a much higher estimate of .5.

Aggregate supply (S) is the sum of production lagged by one year plus imports plus government stocks of foodgrains.

(P_t) represents the foodgrain price index.

In keeping with a prior expectation that changes in the level of money would be a major determinant of the absolute level of prices, the results reveal that the coefficient of the money supply variable was positive and highly significant. However the variable of net aggregate demand was statistically insignificant implying that the changes in price level did not reflect the relative scarcity of sectoral output. These findings are in keeping with empirical work on determinants of farm prices in the Indian economy.[4] The research also indicates that the upward trend in foodgrain prices is explained primarily by expansion of

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1 Rahman (1963).

2 Hufbauer (1968).

3 Gibbs et al. (1966).

4 Mellor and Dar (1968); Parthasarathy and Mudahar (1976); Sidhu and Singh (1979).

money supplied while the impact of sectoral output is insignificant.

The low explanatory power of relative supply may be attributable to the fact that changes in private stocks of foodgrains are not incorporated in the variable. If, as would be expected, years of good crop lead to greater storage and years of bad harvest lead to a depletion of stocks, changes in private holdings of foodgrains would to some extent counteract the influence of production change. However information available for India[1] suggests that farmers storage behaviour does not necessarily follow the expected pattern and is not highly predictable.

The negligible effect on the net aggregate demand variable could also be interpreted as highlighting the importance of government policies, rather than supply demand factors, as the determining influence for the rising trend in farm prices. In the Indian context, the role of government policies, specially policies with respect to administered prices, has been stressed by a number of observers[2] as the principal explanation of the relatively faster rising trend of agricultural prices. The case has been put forward most forcefully in Mitra's study which outlines in detail the repercussions of changes in procurement prices on the level of market prices in the Indian economy.

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1 Mellor and Dar (1968), pp. 968-970.

2 Mitra (1977), pp. 110-112; Rao (1974), p. 12; Shetty (1978), p.207.

Whereas this section was primarily concerned with assessing the effect of supply and demand of sectoral output and changes in money supply on the movement of farm prices, the influence of government policy and the factors which determine price setting decisions in the Pakistan economy will be analysed in the next chapter.

Table A.1
Regression Results

	(D-S) t-1	(D-S) t-2	M t	R 2
b=.22	.015	-.005	.007*	.92

*Significant at the 1% lavel

Source: Kemal and Bilquees(1981); Government of Pakistan, Ministy of Finance, Economic Survey, various issues.

Table A.2

Weights - Non-Agricultural Commodities

	Lewis	Alternative Method
Sugarle	.018	.13
Edible oil	.14	.005
Vegetable Ghee		.07
Tea	.05	.052
Salts and Spices	.012	.083
Beverages	.006	-
Tobacco	.038	.04
Cotton textiles	.25	.36
Silk and Artsilk	.034	-
Footwear	.017	.115
Wood and Furniture	.003	-
Printing and Publishing	.017	-
Soap and Perfume	.024	-
Matches	.009	.01
Jute Textile	.023	-
Paper Manufacturing	.08	-
Leather	.001	-
Rubber products	.010	-
Fertilizers	.146	.04
Medicine	.038	-
Petrol and Coal	.045	.034
Non Metalic Minerals	.012	-
Basic Metal	.02	-
Metal Products	.01	-
Machinery except electrical	.08	-
Electical Machinery	.014	-
Transport equipment	.02	-
Charcoal	-	.0004
Gas	-	.0003
Electricity (final use)	-	.008
Electricity (intermediate use)	-	.023
Diesel oil (intermediate use)	-	.03

Table A.3

Weights - Agricultural Commodities

	Lewis	Alternative Method
Wheat	.228	.22
Rice	.083	.04
Other Cereals	.021	.01
Gram	.04	.01
Other Pluses	.04	.02
Milk	.137	.12
Ghee	.07	.056
Meat	.02	.056
Fish	-	.005
Chicken	-	.005
Eggs	-	.005
Vegetables	.011	.055
Oilseeds	.03	.27
Cotton	.16	.153
Sugarcane	.13	.13
Tobacco	.04	.04
Wool	.014	
Hide and Skin	.014	
Firewood	-	.048

Table A.4

Annual Percentage Change In the Price Indices of Various Agricultural Commodities 1971/72 - 1978/79

	Wheat	Rice	Cotton	Sugarcane	Tobacco
1971/72	14%	5%	9.2%	1%	9.3%
1972/73	3%	50%	21%	32%	1%
1973/74	24%	25%	45%	15%	16.4%
1974/75	54%	15%	-12%	12%	89%
1975/76	-2.6%	10%	20%	21%	2%
1976/77	-1.7%	13%	28%	-2%	8.8%
1977/78	14.7%	14%	14.8%	.1%	9.4%
1978/79	10%	9%	21%	-	11.7%

	Milk	Meat	Vegetable	Jowar	Bajra
1971/72	4%	2%	-24%	24%	23%
1972/73	20%	11%	2%	22%	44%
1973/74	41%	40%	221%	9%	12%
1974/75	29%	37%	-51%	81%	118%
1975/76	13%	13%	13%	12%	.4%
1976/77	17%	10%	52%	-1%	-19%
1977/78	1%	7.4%	-7%	-5.4%	20%
1978/79	4%	2.8%	5%	7%	53%

Table A.5

Annual Percentage change in the Price Indices of Various Non-Agricultural Commodities 1971/72 - 1978/79

	Vegetable Ghee	Salt and Spices	Sugar	Cigarettes	Tea
1971/72	1%	8%	-3%	13.5%	2%
1972/73	-.4%	-1%	32%	3%	25%
1973/74	25%	30%	40%	11%	3%
1974/75	31%	113%	24%	58%	8%
1975/76	14%	-21%	11%	17%	-.8%
1976/77	1%	32%	_	9%	2%
1977/78	-.7%	7%	_	14%	75%
1978/79	3%	2%	—	12%	_

	Cotton Textiles	Footwear	Kerosene Oli	Fertilizers
1971/72	4%	4.5%	19%	-12%
1972/73	7.7%	8%	-1%	-22%
1973/74	64%	16%	27%	34%
1974/75	16%	40%	35%	41%
1975/76	5%	8%	12%	5%
1976/77	17%	8%	5%	-10%
1977/78	9%	17%	1%	-1%
1978/79	-1%	4%	17%	-5%

CHAPTER IV

INTERPRETATION OF CHANGES IN TERMS OF TRADE FOR THE PAKISTAN ECONOMY 1952-1977

Terms of Trade for the Pakistan economy have remained consistently favourable to agriculture since the late fifties. Irrespective of the methodology used, estimates of agriculture's net barter terms of trade have shown a substantial improvement in the past twenty two years. In recent years, estimates of terms of trade derived in this thesis show that the series has been characterized by sharp fluctuations but there is no mistaking the clearly increasing trend during the seventies.

What have been the factors responsible for movements in the terms of trade over time? Empirical analysis on the subject emphasizes the importance of government intervention in price setting. The earlier work by Lewis[1] views the state as neutral and above class and sectional interests. Government policy is determined mainly by economic considerations. The more recent interpretation by Gotsch and Brown[2] and Burki[3] pertaining to terms of trade changes in the seventies, explicitly recognizes the political motives behind state decisions on economic policy. Public policy is seen as a means of furthering the interests of the groups in power. The state is no longer neutral but dominated by urban groups who are the

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1 Lewis and Hussain (1966).

2 Gotsch and Brown (1977).

3 Burki (1980).

principal beneficiaries of it's various policies and programs.

The difference in approach corresponds to changes over the period of the two studies of what was widely accepted in development research as the objective of state intervention in the economic sphere. Lewis's interpretation of economic policies as being guided primarily by the requirements of economic growth reflects the view current in the development literature of the early sixties. Government manipulation of terms of trade was recognised as an instrument for transferring resources between sectors.[1] However the direction of these transfers was determined by the exigencies of development strategy with the objective of maximising the economic welfare of the society.

It soon became clear that the benefits of the development programs undertaken by developing countries were confined to the priviledged strata of society whereas the relative position of the low income groups continued to deteriorate. In the face of the persistence of extreme poverty and increasing income disparities the "growth oriented" policies came under severe criticism. The focus of development research previously limited to the problem of allocation of resources shifted to questions of income distribution,[2] basic needs and poverty. The emphasis

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1 For a detailed account of the neo-classical approach to terms of trade see Mitra (1977), pp. 82-92.

2 The large number of studies on this subject which came out in the seventies include Chenery et al. (1974); Streeten and Burki (1978); Adleman and Morris (1973).

on the distributional impact of state intervention brought the issue of benefits of economic policies to the forefront of the discussion. The links between the beneficiaries of public policy and the groups who weilded power in the state were unambiguous. It became increasingly untenable to justify the concentration of gains in the hands of the priviledged few as a result of mistaken priorities or errors in the choice of development strategy.

The concept of the neutral state lost credibility. While the view that public policy on economic issues should be analysed within a socio-political framework gained increased acceptance even amongst mainstream economists.[1] It was widely admitted that decisions on economic policy were the result of pressure from power blocs in the society who were also their chief beneficiaries.

On the basis of evidence from less developed countries Lipton claimed that the state represented urban interests and government policies were aimed at strengthening the economic position of the urban sector. This urban bias in public policy was responsible for the diversion of a disproportionate share of development funds to the urban sector than could be justified either on the grounds of efficiency or equity. He argued that these policies transferring resources were "based not on wisdom but the pressure and concentration of urban power."[2]

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1 Schultz (1978); Adleman and Morris (1973).

2 Lipton (1977), p.19.

Resources are channelized into the urban sector through a variety of mechanisms such as taxation, credit policy, manipulation of terms of trade etc. The latter is the most effective means of resource transfer. "It is above all by cheapening farm output with private and public powers that transfer savings capacity from agriculture to the rest of the economy.....compulsory procurement, subsidized input disposal, marketing boards, these are three of the many methods used by the governments."[1] The impact of these price twists is felt throughout the economy. "They make temptations for off farm investments more plentiful and for farm investments less so. Price twists also directly encourage workers, managers, educators and suppliers of allocable inputs to switch out of agriculture."[2]

Recent research on agricultural development in Third World countries has been considerably influenced by Lipton's work. The bias in government policies against the farm sector is singled out by various economists as the principal reason for the stagnation in productivity which characterized the agricultural sector in a number of these countries during the seventies.[3]

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1 Ibid., p. 293.

2 Ibid., p. 307.

3 Schultz (1978), pp. 10-13; Brown (1978), p. 84; Lutz and Scandizzo (1980), pp. 15-16.

In the context of Pakistan the influence of the thesis is most noticeable in analysis of changes in relative prices of farm and non-farm output. Mainly on the basis of a comparison of domestic and international prices, these studies[1] claim that price policy has favoured the non-agricultural sector. Following Lipton's reasoning, with no reference to facts on the power structure of the country, the bias in price policy is attributed to the control of the state apparatus by urban groups.

In this chapter an attempt is made to critically examine these various explanations of factors determining relative price movements. The discussion that follows is divided into three sections. The first part provides a more detailed assessment of Lewis's interpretation of changes in intersectoral terms of trade covering the period from 1951/52 to 1969/70. This is followed by a critical analysis of more recent explanations of shifts in terms of trade during the Bhutto period put forward by Gotsch and Brown and by Burki. The final section, on the basis of available evidence on terms of trade, world prices, fertilizer-crop ratios etc., presents an alternative view on the determinants of government price policy decisions.

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1 Gotsch and Brown (1977), p. 101; Burki (1980, pp. 135-141).

Changes in Terms of Trade 1951/52-1969/70

Terms of trade for the period 1950/51 to 1964 have been estimated by Lewis and Hussain and later updated by Lewis up to 1970.

Table 4.1.

Terms of Trade for Agriculture 1951/52-1969/70 (three year moving averages)

1951-54	97.39	1959-62	106.37
1952-55	91.14	1960-63	108.25
1953-56	87.36	1961-64	107.17
1954-57	91.41	1962-65	109.15
1955-58	96.03	1963-66	110.01
1956-59	98.76	1964-67	112.10
1957-60	99.43	1965-68	108.46
1958-61	103.13	1966-69	106.55

Source: terms of trade index for the years from 1951-54 is taken from S. Lewis and S.M. Hussain, Relative Price Changes and Industrialization in Pakistan, 1951-64, Karachi, 1967; the estimates for the later period from 1961/64-1966/69 are taken from S.R. Lewis, "Agriculture's Terms of Trade," Pakistan Development Review, 1970.

Their estimates reveal a fall in agriculture's terms of trade till the mid-fifties followed by an increasing trend tapering off in the late sixties.

Lewis attributes the sharp turn in terms of trade against agriculture in the early fifties to two factors.[1] The sharp fall in export prices and the government trade policy of import control and over-valuation of the domestic currency. The trade policy was an attempt to cope with the balance of payment crises the country faced in 1953. As a result of the collapse of export earnings following the end of the Korean War Boom the import requirements of the economy could not be sustained by it's supply of foreign exchange. To meet the problem of exchange shortage the government decided to impose stringent controls rather than devalue the domestic currency. The result was an increase in the price of imports mostly manufactured goods. At the same time the fall in world prices not accompanied by a devaluation led to a fall in the domestic prices of exports, mostly agricultural commodities.

The subsequent improvement in agriculture's terms of trade from the mid-fifties onward attributed by Lewis to the changes in the relative supply of output in the two sectors.[2] Large scale industry grew at an annual rate of 16.3% for the period from

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1 Lewis and Hussain (1966), p. 413.

2 Lewis and Hussain (1966), p.413.

Table 4.2.

Annual Compound Growth Rates by Sectors at 1959/60 Factor Cost

	1949/50-1959/60	1960/61-1969/70	1963/64-1970/71
Agriculture	1.2	3.7	
Large-scale Manufacturing	16.3		9.0

Source: Growth rates for the period from 1949/50 to 1959/60 are taken from T.M. Khan and A. Bergan, "Measurement of Structural Change in the Pakistan Economy: A Review of the National Income Estimates, 1949/50 to 1963/64", Pakistan Development Review, Summer 1967; growth rate for 1960/61-1969/70 taken from Pakistan Economic Survey 1970/71; growth rate for 1963/64-1970/71 taken from S. Guisinger, "Patterns of Industrial Growth", Pakistan Development Review, 1977.

1949/50 to 1959/60. The rapid growth was a response to high returns of investment, in the range of 50% to 100%, attributable to favourable terms of trade along with various fiscal rebates and cheap credit facilities. On the other hand agricultural output failed to keep pace even with population growth resulting in a decline in per capita agricultural product.

The persistance of relatively higher prices for farm products vis a vis non-farm products in the face of a dramatic increase in agricultural output during the sixties does not run counter to Lewis's argument. Despite the acceleration in the

growth of agricultural production industrial output was still growing as a faster rate. Hence the continued favourable trend in agriculture's terms of trade.

However this does not explain why agriculture's terms of trade should increase sharply with a narrowing of the differential in sectoral growth rates. By attributing the positive shift in relative prices largely to supply factors, Lewis undermines the influence of government policy on prices during the period. The jump in agriculture's terms of trade index coincided with a shift in government price policy in the beginning of 1960. Control on the movement and price of wheat was replaced by a system of voluntary sale to government at a support price of 13.50 per maund. Other measures that followed included a reduction of export duty on cotton, subsidy on fertilizer and other inputs, export bonus on fine quality rice etc.

In analysing factor's responsible for a continued shift in terms of trade in favour of agriculture during the sixties, it would be crucial to consider the influence of the increase in the support price of wheat (with a weight of 42% in the terms of trade index). The support price of wheat was raised from Rs. 13.50 to Rs. 18.50 in May 1968[1] with the official objective of providing incentives to farmers to increase wheat production as a part of the food self-sufficiency program. The price rise was substantially more than what was considered necessary for incentive purposes. On the basis of an empirical study on a 12.5 acre farm in the Northern zone on Punjab, Rs. 11 was estimated as the minimum price up to which it was worthwhile for farmers to grow wheat.[2] Most economists and planners recommend a price increase up to Rs. 14 or Rs. 15 per maund.[3] Obviously non-economic considerations dominated in the decision to fix the price substantially above this level.

The government was persuaded to reduce the price some months later in December 1968[4] not on the advice of economists, but due to the politically volatile situation in the urban areas of the country at the time.[5] However the following year the

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1 Government of Pakistan, Finance Division, Economic Survey 1968-69, p. 100.

2 Falcon and Gotsch. Cited in government document; no source given.

3 Hasan (1976), p. 236; Nulty (1972), p.96.

4 Government of Pakistan, Finance Division, Economic Survey 1968/69, P. 100.

5 For a detailed account of unrest in urban areas in 1968 see Ziring (1971), pp. 92-95.

price was raised again in response to the demands of landed interest. The move is described by Gotsch in the following terms: "An example of their waxing power was the recent re-establishment of the wheat support price in the face of the most unanimous opposition of economists in the provincial and central planning agencies."[1]

To the extent that price policies are determined by the class basis of the state the question arises as to why in the early fifties when the landlords were at the peak of their power that terms of trade were turned against agriculture. Why was the crises in the balance of payments met by a policy of import controls rather than by the devaluation of the rupee, a more favourable option from agriculture's point of view? The major losers of the decision not to devalue were the Bengali peasants. Jute comprised nearly 50% of the foreign exchange earnings and was grown mostly on small farms in the eastern province of the country.[2] The overvaluation of the rupee was a means of transferring the surplus from the Bengali peasants in the form of foreign exchange to the industrialists based in West Pakistan. Thus in the first decade East Pakistan earned on average more than half the total foreign exchange

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1 Gotsch (1976), p. 259.

2 Government of Pakistan, Planning Board (1958), p. 172.

of the country while its share of imports was less than one third.[1] According to an official report the transfer of resources from East to West Pakistan was at the rate of Rs. 730 million a year over the twenty year period from 1948/49 to 1968/9.[2]

The neglect of the interests of East Pakistan was made possible by the dominance of the West Pakistani elites in the policy making structure. The army was almost entirely drawn from the provinces of Punjab and NWFP in the western wing. East Pakistanis constituted not more than five per cent of the officers.[3] A similar pattern was visible in the regional composition of the civil service hierarchy.[4]

The West Pakistani landlords were primarily concerned with maintaining their vast land resources. Information on the concentration of landholdings for the pre-military period[5] has been provided earlier in the study. To get a further idea of the enormous tracts of land involved, the average holdings of the landlords affected by '59 Land Reforms was over 5000

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1 Government of Pakistan, Planning Commission (1970), p. 143.

2 Ibid., p. 73.

3 Sayeed (1968), p. 276.

4 Ayoob (1971), p. 201.

5 See Table 1.1.

acres before surrender of land.[1] Hence avoidance of ceiling legislation was of far greater importance to their economic position than changes in farm prices.

Secondly the large landowners of West Pakistan were the principal beneficiaries of the government program of large scale investments. These irrigation schemes made possible sharp increases in the area under cultivation and thereby the income of this class. For the period from 1951/52 to 1959/60 irrigated land increased at an annual growth rate of 2.11%.[2] The feudal aristocracy made use of their power to divert a disproportionate share of irrigation water to their lands. According to Burki's[3] calculations, out of the 108 members of the landed elite who had held ministerial posts in the premilitary period at least 42 were charged by the military regime for "diverting to their land a higher proportion than allowed by law and custom of the available irrigation water."[4]

Interpretation of Terms of Trade Movements during the Bhutto Period

The net barter terms of trade series, derived in the preceding chapter, reveals a continued increasing trend in favour of agriculture during the seventies. The annual rate of price

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1 Compiled from unpublished Land Commission statistics by Hirashima (1978), p. 69.

2 Hirashima (1978), p. 69.

3 Burki (1976), p. 303.

4 Burki (1976), p. 303.

increase was higher for agricultural commodities vis a vis non-agricultural goods irrespective of the level of aggregation. The differential in favour of agriculture was largest in the case of intermediate products. Whereas terms of trade improved for agriculture as a whole at an annual rate of 0.9%---the increase was specially marked in the case of intermediate products (4.5%) as compared to final goods (1.0%).

Gotsch and Brown in their study on price incentives in the Pakistan economy have claimed that the relative prices of agricultural commodities deteriorated in the seventies.[1] The empirical basis of this conclusion was an extension of terms of trade using Lewis' weights. Their findings reveal a dramatic improvement in agriculture's terms of trade till 1973/74 followed by a steep fall in the index in 1974/75.[2] The sharp downward fluctuation in the series, however, does not warrant the conclusion that the relative price ratio had turned against the farm sector. This fact is brought out clearly by a further extension of the series up to 1978/79 and a dis-aggregated analysis of the factors behind the slump in agriculture's terms of trade provided in Chapter 3. The analysis shows that the decline in farm prices was of a

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1 Gotsch and Brown (1977), p. 39.

2 The estimates derived by Gotsch and Brown are presented in graph form only.

transitory nature while the overall trend in relative prices during the seventies was unambiguously to the advantage of the agricultural sector.

Gotsch and Brown's interpretation of the supposedly unfavourable trend in agriculture's terms of trade differ from the approach used by Lewis in that they explicitly recognise political objectives of government manipulation of relative prices. The state is viewed as mediating between the demands of the relative bargaining position of three powerful constituencies -- agriculturists, industrialists and consumers. Thus "Government decisions concerning argicultural prices have been taken after the considerations of the interests of three major groups: agricultural producers, consumers and manufacturers."[1] The latter two share a common interest in low prices and are representative of the urban sector while the agriculturists represent the rural population. Intra-sectoral conflict of interest between net buyers and sellers of farm output in the rural sector is not mentioned. Whereas the classification of urban groups as industrialists and consumers is also designed to underplay any hint of conflict within the sector.

The influence of the urban bias thesis is clearly evident in the analysis although at one point the authors state that "it is not possible to know the weight policy makers gave to each of

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1 Gotsch and Brown (1977), p. 88.

these interests" the conclusions of the study indicate clearly that it is the urban interests who are pulling the strings of state policy. Thus "..the government has been primarily concerned with stabilizing the prices paid by the consumers and manufacturers for food and raw materials and has systematically held prices received by farmers to far less than world market prices."[1]

The claim that urban interests dominated the state apparatus, even if urban interests are equated with those of the industrialists, is refuted by the discussion in a preceding chapter which clearly pointed to an appreciable reduction in the influence of this group relative to the rural elite during the Bhutto period. In any case lumping together labour and industrialists as representatives of the urban sector is specially misleading during the seventies when the conflict between the two classes was at it's peak. Urban labour was a major constitiency of the Peoples Party and the price policy was used to cater to it's needs. However this objective was achieved not through paying lower prices to the agriculturists but by not allowing the issue price at which wheat was sold to low income consumers to increase with the enhancement of procurement price. The burden of this subsidy was borne by the state exchequer. The cost was substantial but Bhutto from his experience in Ayub's cabinet was very aware of the political implications of a sharp

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1 Gotsch and Brown (1977), p. 101.

increase in food prices. In April '75 when the budgetary constraints made it impossible to maintain the lower issue price the government was careful to similtaneously announce an adjustment in wages as well.[1]

Another recent study by Burki[2] also interprets state decision making on economic issues, including decisions on price setting, within the context of the political framework of the period. The analysis of Bhutto's policies is divided into two distinct periods - from 1972-1974 and from 1974-1977. Each phase is viewed as marking a distinct shift in the groups who dominated the state machinery. In the earlier period representatives of the urban left occupied key policy making positions while the latter period was characterized by the re-emergence and control of the conservative elements of the party. The strength of the more radical faction of the PPP in the initial years was reflected in their control of important portfolios such as finance, economic affairs, planning and industrial production. A reshuffling of cabinet posts in 1974 resulting in the exit of Mubashar Hasan, finance minister, and the appointment of Bucha, an avid spokesman of the large landowners lobby, marked the ascendancy of the more conservative group of the PPP into power.

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1 Government of Pakistan, Finance Division, Economic Survey, 1974/75, p. 102.

2 Burki (1980).

The policies adopted by the state in the early left dominated phase are viewed by Burki as serving the interests of their constituency -- the urban sector. Diverse policies which if anything were aimed at maintaining the progressive posture on which Bhutto had fought the elections are lumped together as exhibiting urban bias. "Nationalization of companies in the more important basic industries, government take-over of the insurance and banking industries, labour reforms, establishment of public sector over private schools and colleges and the introduction of a scheme of generic medicine are examples of measures adopted with a distinct urban bias."[1]

Furthermore the PPP Left's main constituency was urban labour, students and the low income groups not the urban sector as a whole. As mentioned earlier in the discussion conflict within urban groups, specially between the industrialists and labour, was so intense at the time that it's ridiculous to refer to the urban sector as a homogeneous entity with a common platform on important economic issues.

In giving more detailed examples of "urban bias", Burki further confuses the issue and provides evidence which, instead of supporting, seems to refute his hypothesis. One such

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1 Ibid., p. 135.

instance concerns the pricing policy with respect to refined sugar.[1] In the Autumn of '72 due to sharp decline in the output of sugarcane the price of refined sugar doubled. A two-tier system was quickly established under which the urban consumers were permitted to purchase their requirements from ration shops at heavily subsidized prices. The burden of the subsidy was borne by the state since the government could not pass on the burden in terms of lower prices to sugarcane growers. Another illustration of urban bias provided by Burki refers to the "grey cloth scheme" aimed at ensuring adequate production of a type of coarse cloth demanded by poor people.[2] This was implemented firstly by enhancing minimum prices payable to growers with the supposed objective of increasing production of raw cotton and secondly by setting grey cloth quotas for textile mills. Burki himself points out that low income consumers were the intended beneficiaries while the interests of the cotton growers were protected through a higher level of prices. It was the textile owners and cotton traders who were squeezed. Both the examples, far from reflecting "urban bias", serve to illustrate the governments concern to promote the interests of their two major constituencies, urban labour on the one hand and the rural elite on the other.

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1 Burki (1980), p. 136.

2 Ibid., p. 137.

One of the most crucial economic measures undertaken by the regime in the first phase, the devaluation of the rupee, with important bearing on inter-sectoral relations is omitted from the discussion on urban biased policies because it goes contrary to the hypothesis. While the sharp increase in procurement prices is made to fit in with the neat link established between the government of the urban left and pro-urban thrust of policies. Hence according to Burki the enhancement of procurement prices was motivated by a desire to provide maximum amount of food to low income consumers, any benefits to farmers were incidental.[1] In any case he claims that the farmers gained little or nothing since the cost of inputs increased more than proportionately to the price hike. Empirical support is provided for the argument by a comparison of the real cost of purchasing inputs in 1973/74 to the level that prevailed in the sixties. "However in 1973/74 at the height of the PPP Left's power the real cost of purchasing inputs by farmers growing wheat was more than double that during the 1960's."[2] No further reference is made as to what is meant by "real cost" or as to how it is derived. An obvious measure for assessing the impact of changes in the output and input prices on the relative position of farmers is the intersectoral terms of trade series. Although Burki duscusses estimates of terms of trade derived by Gotsch and Brown at various points

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1 Burki (1980), p. 157.

2 Ibid., p. 156.

in the analysis,[1] he makes no attempt to use the results to substantiate his claim that the farmers did not benefit from the enhancement in procurement prices in 1973/74. The most probable reason for this neglect is that the estimates provided evidence of a sharp shift in favour of agriculture in 1973/74 totally contradicting Burki's line of argument.

Movements in terms of trade during the Bhutto period present a problem from the point of view of Burki's analysis as the direction of changes does not tie in neatly with the interests of the groups in power. The index registers sharp increases up to 1973/74, the heyday of the urban left, followed by a decline at exactly when according to Burki the pro-agricultural lobby came into power.

To get around this contradiction Burki draws a distinction between the interest of middle and large landowners.[2] The middle farmers, defined in an early study[3] as those with holdings between 50 and 100 acres, specialize in the production of wheat and rice whereas larger farmers mainly grow cash crops such as cotton, sugarcane and oilseeds. Not only is the crop composition different between these two size category of farmers but there is also considerable variation in the level of input use. The large farmers use "seed variety

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1 Ibid.

2 Burki (1980), p. 157.

3 Burki (1976), p. 307.

that do not need much application of chemical fertilizers"[1] while middle farmers use a larger amount of modern inputs and high yielding seed varieties. On the basis of these differences the incentive structure, and hence the terms of trade, facing the two classes of farmers is entirely different.

From here Burki goes on to argue that the decline in aggregate terms of trade for agriculture masked considerable variations in relative prices facing the different class of farmers. The middle farmers suffered. "The changes in the prices of inputs and outputs during this period took away the incentive that the price and subsidy policy had provided to the middle class farmers in the Ayub period."[2] Whereas the government dominated by the representatives of the landed elite ensured that the terms of trade continued to favour large landowners. In this context Burki specially mentions the cotton growers of the Punjab.[3]

However once again Burki's argument is refuted by the available empirical evidence. Examination of price data at a more disaggregated level revealed that it was the decline in prices in the intermediate goods sector, specially raw cotton, which caused the slump in agriculture's terms of trade in 1974/75 in the first place. Furthermore there is no

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1 Burki (1980), p. 158.

2 Ibid., p. 158.

3 Burki (1980), p. 15.

justification for classifying middle and large farmers separately on the basis of the fact that they face different sets of output and input prices and hence different sets of terms of trade. Available data does not support either the proposition that there is such a wide variation in the crop composition for the two groups of farmers[1] or the generalization of differences in the type and level of inputs used by the middle and large sized farmers.[2]

Alavi had aptly criticised Burki's thesis of a conflict of interest between the two categories of farmers. "We cannot accept the implication that they constitute separate classes, since their interests do not conflict. Their grounds on all essential issues of public policy are identical whether they be questions of prices of agricultural commodities, taxation of agricultural incomes or provision of facilities and services and subsidized inputs to landowners. Similarly they share an identical position on issues of class

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1 The breakdown of crop composition by farm size provided in the 1972 Census of Agriculture does not reveal any marked difference between the two largest size categories (50-150 acres and 150 acres or more) with respect to area allocated to foodgrains (Government of Pakistan, Agricultural Census Organisation, 1976, p.13).

2 Available evidence indicates a positive relationship between size of farm and use of modern inputs i.e. fertilizers, mechanical inputs etc. (Khan 1975, pp. 112-115; Ercelawn, 1979, p. 223; Hussain 1980, p. 147-148). However in most of these studies landholdings of 50 acres or more are classified as large farms whereas Burki defines middle farmers as operating farms of between 50 and 100 acres. The only empirical work which provides a further breakdown of farms into categories of 50-150 acres and 150 acres plus (Hussain 1980, p. 147.) shows that the use of modern inputs is higher in the larger size group.

relationships in the rural society vis a vis sharecroppers and landless labourers and on questions of public policy and legislation."[1] The middle and rich farmers are on the same continuum of interest with respect to issues of prices, inputs, land reform etc. From the point of view of the differential impact of terms of trade a more useful distinction would be between subsistence and non-subsistence farmers. As Mitra[2] has emphasized the conflict of interest over prices is between farmers who are net sellers of output and those who are net buyers.

Finally fixing on 1974 as the point marking the switch from "urban biased" policies to pro-agricultural policies is misleading and of no analytical significance. Although the changes in 1974 led to the exit of a prominent representative of the leftist faction, the deradicalization of the party apparatus was almost complete soon after Bhutto came into power in 1972.[3] A few leftists were kept on to maintain political identity as a progressive government. Even after the reshuffling of top positions in 1974, the Ministry of Agriculture was placed under the control of Sheikh Rashid, the only remaining socialist in the cabinet, to placate the more progressive component of PPP support. Furthermore the

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1 Alavi (1976), pp. 340-341.

2 Mitra (1977), p.97.

3 Lodhi (1980), p. 409.

tilt in economic policies in favour of the landed elite was visible long before this point. The land reforms of '72 reflected a political compromise in favour of the feudals. Devaluation, credit policies, frequent increases in procurement prices, policies undertaken before the 1974 demarcation point, conferred further economic gains to this class.

Determinants of Price Policy: The Bhutto Period

Gotsch and Brown have claimed that the government price policy during the seventies was motivated by the objective of maintaining low agricultural prices for the benefit of the manufacturing sectors.[1] In this section it will be shown on the basis of available evidence that on the contrary state decision making on prices was biased in favour of agriculture and the frequent enhancement of procurement prices were more than would have been warranted on economic considerations alone.

A look at the production and price data for the two sectors, presented in table 4.3 confirms the fact that the changes in terms of trade did not merely reflect the relative scarcity of sectoral outputs. Even though agricultural output increased at the same rate as industrial production from 1970/71

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1 Gotsch and Brown (1977), p. 101.

Table 4.3
* Trend Rates of Growth of Output and Price Indices for Agriculture and Industry 1970/71-1978/79

1. Index of agricultural output	2.5%
2. Index of industrial output	2.5%
3. Index of prices received by agriculture	15.2%
4. Index of prices received by Industry	12.9%

Source: (1) and (2) based on data from Government of Pakistan Economic Survey ,1977/78; (3) and (4) are taken from table 3.8, chapter III of this thesis.

* Trend rate of growth of output is estimated by : log Y=a+bt.

to 1976/77, the prices received for farm products showed a relatively greater increase at 15.7% as compared to the corresponding figure of 14.5% for the manufacturing sector. Hence prices moved in the opposite direction to what would be expected on the basis of the relative supply of output of each sector.

Government policies with respect to devaluation of the rupee and procurement prices were among the major factors contributing to the considerable improvement in agriculture's terms of trade during the period. The decision to increase procurement prices was rationalized each time in terms of the necessity of providing greater incentives to stimulate agricultural production and to compensate for the increase in input costs. Irrespective of the specific factors limiting production in a particular year the appropriate remedy to the problem invariably lay in greater incentives through higher prices or subsidies or both. The descrepancy in officially cited causes and solutions of shortfalls in agricultural output is clearly illustrated in the government assessment of farm sector performance and policy prescriptions for 1974/75.

The year was marked by a decline of over 2% in value-added in agriculture.[1] According to the Economic Survey, the annual

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[1] Government of Pakistan, Economic Survey 1974/75, p. 14.

official assessment of economic performance, the fall in production was "explained mainly by shortage of irrigation water, rains and pest attack on sugarcane and cotton crops. Canal water flow at the farm gate fell to as low as 60% during critical months for important crops. Similarly there was not sufficient rain when critically required..."[1] Unrenumerative farm prices were not mentioned as a possible reason for the crop failure.

However the measures taken to increase production was to substantially raise the procurement prices of major crops - wheat, sugarcane, and rice - which had just been increased in the previous year (Table 4.4.). Thus with respect to wheat "it is necessary to accelerate the pace of improvement in yield per acre as a steady growth in wheat production substantially higher than the rate of increase in population is needed to reduce and eventually eliminate food defecit of the country. Government has taken special measures. The sale price of fertilizers was reduced for 6 weeks with effect from Dec. 1, 1974 to encourage more use of fertilizer for wheat. The support price has also been enhanced from Rs. 25.50 to Rs. 37."[2]

The increase in the price of sugarcane by nearly 25%

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1 Ibid.

2 Ibid., p. 15.

Table 4.4

Procurement and Minimum Prices for Agricultural Commodities
(rupees/mds.)

	69/70	70/71	71/72	72/73	73/74	74/75	75/76	76/77	77/78
Wheat	17.00	17.00	17.00	22.50	27.50	37.00	37.00	37.00	37.0
Rice									
Basmati	35.00	32.00	38.00	46.00	62.00	90.00	90.00	90.00	95.00
IRRI-6	21.00	21.00	21.00	21.00	27.00	40.00	40.00	40.00	46.00
IRRI-8	18.50	18.50	19.50	19.50	25.00	38.00	40.00	40.00	38.00
Kangani	19.00	19.00	19.00	20.50	26.00	39.00	39.00	39.00	39.00
Cotton (seed cotton)									
American Variety	-	-	-	-	-	-	-	125.00	138.00 to 160.00
Desi Variety	-	-	-	-	-	-	-	120.00	132.00
Sugarcane (factory gate)									
NWFP	2.75	2.75	2.25	4.00	4.00	5.00	5.50	5.50	5.50
Punjab	2.75	2.75	2.50	4.25	4.25	5.25	5.75	5.75	5.75
Sind	2.90	2.90	2.65	4.40	4.40	5.40	5.90	5.90	5.90
Maize	-	-	-	-	-	-	-	32.00	32.0
Potato	-	-	-	-	-	-	-	25.00	25.0
Onion	-	-	-	-	-	-	-	18.00	18.0

Source: Government of Pakistan, Ministry of Food, Agriculture and Co-operative, Agricultural Statistics of Pakistan, 1978.

from Rs. 4.25 per md. in 1973/74 to Rs. 5.25 in 1974/75 was specially unjustifiable in terms of incentive consideration. The shortfall in sugarcane output reflected declining yields which were attributed in the Survey to "poor germination, poor rains during monsoons, shortage of irrigation water and attack of sugarcane borers."[1] Area under the crop had increased by nearly 6% from 15.74 lakh acres in 1973/74 to 16.55 acres in 1974/75.[2] The shift in acreage reflected more than adequate incentive for the cultivation of sugarcane. A fact which was officially recognized in the same document. "The improvement in acreage was in response to higher prices of sugarcane, gur and shakkar."[3]

A more detailed assessment of factors that influence government decisions on the setting of procurement prices will be provided in the discussion that follows. An attempt will be made to see to what extent the evidence on costs of acquiring inputs, level of world prices of farm crops, the rate of return etc., support the claim made in government publications that the appreciable increase in prices during the period were necessary to maintain incentives in the face of rising costs.

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1 Ibid., p. 18.

2 Ibid.

3 Ibid.

Before proceeding with the discussion it would be useful to briefly list the main elements of the government procurement program in Pakistan.[1]

(i) Announcement of procurement prices. Procurement prices in Pakistan have a dual function. Apart from the price at which the government buys surplus wheat, it also serves as a support price which sets a lower limit to price movements.

(ii) Building up of buffer stocks to meet emergency situations and/or mitigating seasonal fluctuations.

(iii) Running a public distribution system for safeguarding the interest of low income consumers.

Procurement has been a regular phenomenon in Pakistan. However till April 1960 it was on a compulsory basis and entailed direct control over market price and movement of wheat. The government fixes from time to time procurement prices of major crops (wheat, rice, sugarcane) at which it purchases from farmers and issue prices at which it sells to low income consumers.

Decisions to enhance procurement prices are determined by various factors. Government background papers provide[2]

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1 Turvey and Cook (1976), p. 112.

2 Government of Pakistan, Pricing Policy Packages (files from 1972/73 to 1977/78).

information considered necessary to guide price setting, mostly data on rates of return, world prices, cost of acquiring inputs, crop-fertilizer price ratios etc. These papers assume a very strong relationship between prices on the one hand and agricultural production and input use on the other. Hence any set back in output targets or any short fall in fertilizer offtake is to be remedied by an increase in incentives in terms of higher prices of output or lower prices of inputs.

One most frequently cited reason for the increase in procurement prices in the early seventies was the increase in fertilizer prices[1] during that period. Price of a bag of urea went up by 111.4% between October '72 to April '74. On the assumption used in most government studies that fertilizer consumption constitutes 10% of total cost, the average increase in overall cost as a result of the change in fertilizer prices would be roughly 12%. To compensate for the higher price of fertilizers procurement price of wheat was enhanced by 114%, of sugarcane by 110%, of Basmati rice by 181% and of Irri-6 variety by 90% over the same period.

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1 The price of a 110 lb. bag of urea was increased from Rs. 25.50 to Rs. 35 in October 1972 and then to Rs. 42 in March 1973. In the financial year 1973/74 fertilizer prices were adjusted three times reaching a peak of Rs. 75 per bag in April 1974. The initial increase in prices in 1972/73 was motivated by a need to reduce the subsidy element. Subsequent increases were necessitated by a sharp jump in international prices. The sale price of Rs. 75 implied a considerable subsidy since the estimated imported fertilizer cost was Rs. 160 per bag.

Table 4.5

Sale Price of Fertilizers 1961-1976 (rupees per bag)

	Domestic			Imported		
	Ammonium Sulphate	Urea	Super Phosphate	Ammonium Sulphate	Urea	Triple Super Phospahate
1961/62	7.75	-	6.00	-	-	-
1962/63 to 9-1-64	11.00	-	11.00	-	24.25	-
10-1-64 to 23-9-65	8.00	-	7.00	-	25.00	-
24-9-65 to 7-6-66	8.50	-	7.50	-	25.00	-
8-9-66 to 28-8-68	11.00	-	10.00	11.00	25.00	19.00
29-8-68 to 26-3-69	11.50	26.00	9.50	11.50	26.00	20.00
27-3-69 to 28-6-70	13.00	26.00	9.50	17.00	28.50	28.00
29-6-70 to 2-7-70	17.00	28.50	9.50	17.00	28.50	20.00
3-7-70 to 31-7-70	17.00	31.00	9.50	17.50	31.00	20.00
1-8-70 to 24-9-72	17.00	28.50	9.50	17.00	28.50	20.00
25-9-72 to 29-1-73	17.00	35.00	9.50	17.00	35.00	20.00
30-1-73 to 30-3-73	17.00	35.00	9.50	17.00	35.00	20.00
31-3-73 to 10-8-73	20.00	42.00	11.00	20.00	42.00	26.00
11-8-73 to 19-4-74	25.00	55.00	25.00	25.00	55.00	34.00
20-4-74 to April 1976	34.00	75.00	34.00	34.00	75.00	35.00
weight of Bag	42 lbs.	112 lbs	112 lbs.	110 lbs.	110 lbs.	-
Nutrient Content	21%N	46%N	18%P	21%N	46%N	46%P

Source: Government of Pakistan, Economic Survey, 1978-79.

Fertilizer crop price ratios reached a peak in April 1974. Subsequent changes in input/output prices have lead to a declining trend for all crops. With respect to Basmati rice the real cost of fertilizer has fallen close to the levels prev alent in the mid sixties (Table 4.6).

On the other hand comparable estimates for India presented in Table 4.7 , show a continued increasing trend. The price of fertilizers for wheat growers in India was cheaper than their counterparts in Pakistan at the beginning of the decade but by 1976 the situation was reversed with the Pakistani farmer being in a more advantageous position. Although in terms of rice, fertilizers were cheaper in Pakistan in 1971/72, the differential increased considerably and by April 1976 the price of fertilizer to rice growers in Pakistan was half that in India.

The above comparison with data for the Indian economy points to the much higher importance assigned by government policy in Pakistan to maintaining a favourable output-input price ratio as a means of encouraging fertilizer consumption. However fertilizer is a function of technological change as well as price. While government policy stressed the effectiveness of price as a determinant of input use it underplayed the powerful incentive of higher productivity associated with

Table 4.6

Fertilizer-Crop Price Ratios (lb, of crop necessary to buy a lb. of Nitrogen

	Wheat	Basmati Rice	Irri-6 Rice	American Seed Cotton	Sugarcane	Maize
1961-62	1.44	.77	-	.56	7.67	1.53
1962-63	2.94	1.47	-	1.31	15.67	2.76
July-Dec '63	2.94	1.38	-	1.21	23.50	2.76
Jan-June '64	1.75	.82	-	.69	14.00	1.47
1964-65	1.75	.82	-	.60	9.33	1.55
Oct '65-Jan '66	1.81	.82	-	.60	9.67	1.55
Feb-June '66	1.61	.85	-	.64		1.61
1966-67	2.72	1.44	-	1.04	24.50	2.53
1967-68	2.43	1.29	-	1.17	17.00	2.45
1968-69	2.43	1.11	-	1.16	17.00	2.83
1969-70	2.83	1.19	1.96	1.16	17.00	2.68
1970-71	2.67	1.44	2.15	.93	18.67	2.95
1971-72	2.67	1.22	2.15	.98	18.67	2.56
July-Sept '72	2.67	1.00	2.15	.84	18.67	1.93
Sept '72 to March '73	2.56	1.23	2.65	1.03	13.80	2.38
July-Aug '73	3.07	1.11	2.52	.75	16.60	2.68
Aug '73 to April '74	4.04	1.45	3.30	.98	21.80	3.52
April-June '74	4.77	1.97	4.48		29.60	4.77
1974/75	3.29	1.36	3.02	1.53	24.67	2.74
1974/75(for 5 weeks from Dec 19 1974	2.89	1.19	2.65	1.34	21.67	2.41
July '75 to April '76	3.29	1.36	2.55	1.22	21.14	
April-June '76		1.16	2.37	1.10	19.14	
1976/77	2.97	1.16	2.39	.88	19.14	
1977/78	2.97	1.16	2.23	.88	19.14	

Source: Government of Pakistan, Fertilizer-crop Ratios, Unpublished.

Table 4.7

Fertilizer-crop price Ratios-India (lb. of crop needed to buy 1 lb. of Nitrogen)

	Wheat	Rice
1971/72	2.54	3.77
1972/73	2.64	3.60
1973/74	1.90	3.08
1974/75	3.45	4.73
Dec '75	3.53	5.28
May '76	3.90	5.43

Source: Nandal and Gower, "Input Prices, Profitability and production", Indian Journal of Agricultural Economics, July-Sept, 1976.

technological improvement. Statistics on fertilizer subsidies and expenditure on agricultural research for Pakistan and some other Asian countries (Table 4.8) leave no doubt as to the high priority assigned to price incentives rather than technological progress as a means of increasing production.

Table 4.8

Fertilizer Subsidy, Agricultural Research Expenditure in Selected Countries 1969-1975

	Subsidy Expenditure (million $)	Agricultural Research Exp.	Subsidy as % of Agr. Research Expenditure
Afghanistan	15.10	.63	2397
Bangladesh	14.63	1.40	1045
Indonesia	71.90	3.42	2102
Iran	36.08	16.66	217
South Korea	27.26	2.44	1117
Pakistan	20.97	1.26	1664
Phillipines	36.77	7.96	462
Sri Lanka	5.25	2.44	215

Source: M.S. Mudahar, "Needed Information and Economic Analysis for Fertilizer Policy Formulation", Indian Journal of Agricultural Economics, July-Sept., 1978.

Due to the varied conditions prevalent in Pakistan agriculture it would be impossible to work out average cost

of production and net profit of various crops which could be representative for all regions, different soil conditions and different sized holdings. However the Planning Commission has carried out exercises[1] to determine cost of production and net profit of different crops for leading farmers (defined as belonging to the upper 10% of farms) and operating a 12.5 acre farm in the Punjab. The objective of these exercises is to provide information to guide price setting decisions and as such they are an integral part of background papers on price policy. Given their limitations they are at best rough indicators of relative profitability over time rather than measures of absolute levels of returns.

To the extent that increase in procurement prices were meant to ensure adequate incentives in the face of rising input costs, they more than fulfilled the objective. Table 4.9. shows clearly that net profit had increased substantially at a faster rate than the general price level, even taking into account the increase in the prices of fertilizers and other inputs. It is interesting to note that despite the high levels of returns on all crops in 1973/74 further

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1 Government of Pakistan, Planning Commission, Cost of Production of Various Crops under Irrigated and Unirrigated Conditions, Central Punjab, issues from 1973/74 to 1977/78.

Table 4.9.

Per Acre Net Profit[1] (excluding land rent) for Average Leading Farmers in Punjab (irrigated districts)

Crops	1970-71	1973-74	1974-75	1975-76	1976-77
Wheat (Mexi-Pak)	101.21	259.78	390.03	371.50	388
Rice (Basmati)	167.58	217.14	728.22	660.34	460
Rice (Irri-6)	341.28	340.67	712.17	600.54	539
Sugarcane	166.23	639.30	817.60	587.60	842
Cotton	185.03	645.99	419.36	795.17	632
Maize	159.34	279.50	592.22	587.92	584

Source: Government of Pakistan, Planning Commission, Cost of Production of Various Crops under Irrigated and Unirrigated Conditions, Central Punjab.

increases in procurement prices were announced for the financial year 1974/75. The official reason was that the enhancement of procurement prices was necessary to "encourage increased production" and "to enable farmers to absorb higher prices of key inputs."[2] It is obvious that there were more than adequate incentives available and government policy was guided by the political objective of ensuring benefits to a very crucial power bloc, the landed elite.

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1 Estimates of net return, as well as fertilizer-crop price ratio presented earlier, are based on procurement prices where applicable. Rice is procured by the government on a monopoly basis (only 10% of stocks of Basmati and 25% of inferior variety are allowed for sale to the private agencies) since 1972/73. However a fair proportion of the marketable surplus of wheat is sold in the open market. Open market prices are usually higher than procurement prices by a fair margin.

2 Government of Pakistan, Finance Division, Pakistan Economic Survey 1974/75, p. 20.

Most research studies on price incentives in the Pakistani context rely on a comparison of domestic and world prices as sufficient empirical basis for establishing the downward bias in government price policy. World prices are frequently used as a benchmark for measuring distortions in agricultural prices. Most such comparisons begin with the qualification that international prices may be neither free nor equitable nor reflecting relative scarcity. However any movement away from these prices is considered sufficient proof of implicit taxation of agriculture and a transfer of income to urban groups.

In view of the instability of international prices of agricultural commodities and evidence of a secular decline in their terms of trade vis a vis manufactured goods it is certainly not necessary that parity with world prices would have benefited domestic farmers. Furthermore if the principal aim of prices is to elicit necessary supplies of agricultural commodities the rate of return would be a more complete measure of incentives to invest.

Setting aside theoretical objection, even if world prices are accepted as a norm for comparison, the changes in

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1 Government of Pakistan, Finance Division, Pakistan Economic Survey 1974/75, p. 20.

Table 4.10

Ratio of Domestic to Border Prices for Selected Crops (percent)

	Wheat	Rice Fine	Raw Cotton	Maize	Rice Medium
1972/73	81	79	74	134	64
1973/74	63	60	57	43	40
1974/75	68	42	71	59	33
1975/76	81	64	81	105	57
1976/77	99	109	59	83	69
1977/78	114	94	87	124	63
1978/79	97	53	100	128	67

Border Price: With the exception of maize, unit values of export are imports are used. In the case of maize International price (U.S. NO.2 Yellow F.O.B. Gulf port) plus freight (US to india) is converted at the official exchange rate. Also for maize the time period is the calender year - so 1972/73 refers to 1972 and so on. Data on unit values of taken fromthe World Bank. Commodity Trade and Price Trends, August 1979.

Domestic prices: Annual average wholesale prices at Karachi taken from Government of Pakistan, Market and Prices, various issues.

the two sets of prices over the seventies do not point to a policy of maintaining low agricultural prices.

The ratio of domestic to international prices was lowest in 1973/74 and 1974/75 (Table 4.10) due to the combined impact of the devaluation of the rupee and the dramatic increases in world prices. The situation changed considerably from 1975/76 onwards when international prices showed a declining trend while procurement prices continued at the higher level. By the end of the decade domestic prices were comparable or greater than world prices for wheat, maize, sugarcane and cotton seed.

Table 4.11

International and Domestic Price Indices

	Index D	Index I
1971	108.95	109.65
1972	118.35	132.50
1973	137.00	219.00
1974	176.70	389.30
1975	215.80	303.50
1976	232.80	246.20
1977	253.20	205.31
1978	281.50	217.80

Source: weights are based on share in value-added of various crops in 1969/70; domestic wholesale price indices are taken from The Statistical Bulletin 1978/79; international price indices are taken from World Bank (1979).

Index D and Index I represents trends in international and domestic prices of seven major crops -- wheat, rice, maize, sugarcane, cotton, tobacco and oilseeds. Both indices are based on identical weights. The international index shows, initially, a much steeper price increase it reaches a peak in 1974/75 and then declines significantly. In contrast the index based on domestic prices shows far less fluctuation and a continued increasing trend. Contrary to the general view it seems that inflation in world prices of primary commodities and fertilizers was a favourable climate for pegging up prices. Once established procurement prices remained at the higher level despite subsequent fall in international prices and a downward adjustment in fertilizer prices.

The main beneficiaries of favourable terms of trade were the large farmers, a sub-sector of the rural population. Estimates based on the 1972 Argicultural Census data reveal that over 41% of the cultivating population in Pakistan operate holdings of 7.5 acres or less which barely produce enough for their production and consumption needs.[1] This stratum of the rural economy are likely to be net buyers of output. They usually sell some output to meet their immediate cash requirements but later in the year they buy back grain for their consumption needs often at higher prices. Within

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[1] Hussain (1982), p. 336.

the subgroup of net sellers benefits are proportionate to sales. It has been shown that large farmers market a much larger proportion of their output[1] and due to their greater holding capacity can take best advantage of seasonal fluctuations in price.[2]

Price policy was motivated by the political objective of rewarding this class of large landowners, a very important source of support for the ruling party. As the evidence on world prices, costs etc., analysed in this section makes clear, the rate of increase in procurement prices was more than warranged by considerations of economic incentives alone. The price setting process in the seventies represented a continuation of the experience of the sixties whereby large farmers always succeeded in getting higher procurement prices than those recommended by the planning agencies. A detailed discussion of the political power of this class is provided in a preceding chapter, the present analysis serves to illustrate the use of this bargaining strength to influence price policy to their economic advantage.

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1 Ercelawn (1980), pp. 236-237; Government of Pakistan, Ministry of Food and Agriculture (1976), p. 6; Raquibuzzaman (1966), p. 381.

2 Government of Pakistan (1976), p. 17.

CHAPTER V

AGRICULTURAL TAX POLICY IN PAKISTAN

Taxation of the agricultural sector is a major instrument for mobilisation of the surplus and redistribution of income in the economy, the two most crucial problems facing developing countries today. Yet despite its importance the subject has been largely neglected in empirical research on the Pakistan economy. This chapter attempts to redress this imbalance. It will do so first, by bringing together and critically evaluating the existing work on the subject. Secondly, independent estimates of the incidence of taxation by sectors will be derived which in conjunction with the assessment of available evidence will provide a sounder empirical basis to the question of the adequacy of agriculture's contribution to tax revenue. Finally the direction of tax policy with respect to the farm and non-farm sector will be examined within the context of the political objectives of the state.

The discussion will proceed along the following lines. It will begin with a brief examination of the case for agricultural taxation in terms of development and distribution objectives. This will be followed by a critical review of empirical work on sectoral tax burdens for the Pakistan economy. The third section will provide estimates of the incidence of taxation for the agricultural and non-

agricultural sector for the period from 1972/73 to 1976/77. These estimates along with available empirical research will be used to see whether the farm sector is adequantely taxed on the criteria of equity. This will be followed by a discussion of the contribution of tax revenue, specially agricultural taxation, to the developmental objective of resource mobilization in the context of the Pakistan economy. Finally, the analysis will focus on the approach of various regimes to the question of taxation of agricultural incomes and the reform of the land tax structure. An attempt will be made to see whether the failure to institute any significant reforms of the agrarian tax structure was attributable to administrative infeasibility or the low revenue potential of these reforms, the frequently cited official reasons, or was it a further illustration of the power of the rural elite to withold any measures detrimental to their interests.

Theoretical Case for Agricultural Taxation and Some Evidence on its Implementation in Less Developed Countries

A principal objective of tax policy in less developed countries is to raise the overall level of savings in the economy and to direct them into productive investment. Aggregate voluntary savings in these countries fall far short of the resource requirements of a development program. Not only is the level of private savings low but a considerable proportion of these savings is diverted into unproductive channels like real estate, inventory speculation and precious metals. Fiscal policy serves to step up the level of capital formation in the economy indirectly by encouraging private capital through a system of subsidies and tax concessions and directly by generating development resources to be invested in social overheads or to be used as a source of government finance for private entrepreneurs.

In this context agriculture, by virtue of the fact that it is the largest sector in most developing countries, is expected to make a significant contribution to the resource mobilization effort in the public sector. The importance of agricultural taxation in the development literature also derives from its role as a major mechanism for transferring resources from agriculture to finance the expansion of industrial investment.

Mobilization of agricultural surpluses through tax policy or changes in intersectoral terms of trade have played a strategic role in the development policy of several centrally planned economies as well as a number of capitalist countries.

The use of heavy land taxation in the Meiji period in Japan is the most often cited example of effective use of tax policy for financing development. Growth in farm productivity made possible by capital saving technological innovations provided a surplus which was tapped through land taxes for capital formation. In the latter part of the nineteenth century land taxes contributed between 85%-90% of central tax revenue.[1] The disproportionately high burden of taxation on agriculture can also be judged from the fact that between 1883-87 more than one-fifth of farm income was paid out in the form of direct taxes as compared to the figure of 3% for the non-farm sector.[2] The extraction of such a substantial portion of agricultural surplus was achieved without any negative effect on farm productivity.

However recent research has led to some major qualifications of this general view of the Japanese development model which considerably limits it's applicability to present day Third World countries. Firstly, it has been shown that

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1 Okhawa and Rosovoky (1960), p. 63.

2 Ibid.

prior to the Meiji period substantial capital expenditure had already been undertaken in irrigation and other key land development projects which were an essential pre-requisitie of the later successful adoption of the labour intensive fertilizer-seed technology.[1] Secondly it is claimed that when the Meiji land tax was enacted Japanese agriculture was in a more prosperous state than the situation in most developing countries today.[2] Finally the land tax structure of Meiji Japan was too highly regressive to be politically acceptable in these countries.[3]

Furthermore the emphasis in recent thinking on the question of intersectoral resource transfer has shifted to the problem of the investment requirements of the agricultural sector itself. It is increasingly argued that the principal task of agricultural development is not only to finance key capital projects within the sector but also to raise the income and consumption level of the large rural population.[4] However this approach does not imply a reduced priority on agricultural taxation. As Bird has pointed out "even if the capital is used for development of the agricultural sector itself, the role of tax policy in mobilizing savings in that sector may of course be vital."[5]

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1 Smith (1968); Hayami and Yanada (1958).

2 Ishikawa (1967).

3 Ranis (1959).

4 Hunter (1969).

5 Bird (1974). p. 19.

Apart from considerations of economic objectives, a strong case can be made for comparable tax treatment of agriculture on the basis of the traditional fiscal canon of equity which "demands that the burden involved in rapid economic development be distributed equally among the different sections of the population".[1] There are two aspects of equity; tax paying units in similar economic conditions should be treated equally (horizontal equity), whereas those with greater ability to pay should bear a greater tax burden (vertical equity) whatever the sectoral origins of the income.

Thus in theory irrespective of the relative roles of agriculture and manufacturing in the development strategy, taxation of agriculture is expected to make a substantial contribution to government savings on the basis of both economic and equity criteria. However in practice the evidence from most third world countries indicates that they are not mobilizing any significant amount of resources from agriculture through taxation. Their fiscal performance is specially inadequate with respect to direct taxes on the farm sector, there being hardly any attempt to utilize an effective system of land or income taxation. Hence Bird concluded a survey of agricultural tax systems in a number of developing countries on the following note: "It is thus no exaggeration

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[1] Chelliah (1960), p. 67.

to say that not one developing country has to date utilized the undoubted potential of properly constructed agricultural taxes as a point of conscious development policy as well as to raise revenue".[1]

While another study commenting on the relevance of the Japanese experience to present day India stated that "the government of India may not resort to the severe measures of land taxation adopted by Japan in the Meiji period but the difference between 15% and 20% of income paid in the Meiji period to the meagre 1.5% paid by India is too glaring".[2]

Most explanation of this discrepancy between the strong case for effective taxation of agriculture in theory and its less than half-hearted implementation in practice inevitably make some reference to political and administrative obstacles. The following comments by Bhagwati on the subject are fairly representative: "In many instances the hesitation to tax the agricultural sector is traceable to political factors although administrative difficulties are generally cited as the explanation. Either rural votes have to be safeguarded - a question of great significance in most democratic less developed countries in view of the massive rural sector or the landed interest constitute an oligarchy powerful enough to block further taxation of the agricultural

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1 Bird (1974), p. 41.

2 Cutt (1969), p. 146.

sector".[1]

Lipton in his study on urban bias in Third World countries not only emphasises the importance of the political determinants of government decision making on tax issues but goes further to state that tax policy, more than any other policy instrument, provides the clearest indication of the relative bargaining strength of rural and urban interest groups. Thus "tax burdens represent conscious and integrated public policy more clearly than do the mass of largely ad hoc governmental decisions on prices and investments" and "provide convenient foci to examine administrative, legislative and executive decision procedure on the farm and non-farm balance".[2]

However the picture provided in Lipton's thesis of the political scenario of third world states and of the relative sectoral tax burdens in these countries goes contrary to the more widely held view on the subject presented earlier in this chapter. It is claimed that the rural sector in most developing countries bears a larger share of taxes than can be justified either on ground of equity of efficiency. The explanation for the adoption of such an inequitable tax structure lies in the domination of the state by powerful urban

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1 Bhagwati (1966), p. 78.

2 Lipton (1977), p. 272.

groups who use their tremendous influence to resist government policies, including tax policy, which go against their economic interests. On the other hand there are fewer political obstacles to imposing a disproportionately heavy tax burden on the weak and vulnerable rural sector. Hence "in almost all poor countries, immediate political stress can be reduced by taxing the many, the dispersed, the weak -- the rural people -- more heavily, compared to the townspeople, than would be the case if political stress were determined by an egalitarian or democratic balance of influence".[1]

The over-taxation of the rural sector is not confined to the lower strata but is equally true of the rich farmers. Several reasons are put forward by Lipton as to why, in most cases, even the large landowners bear a heavier burden of taxes in relation to taxable capacity than comparable urban income groups.[2] The most important among these is the greater negative impact on their income of the policy of maintaining unfavourable terms of trade for farm output. Although Lipton concedes a few instances whereby the rural elite may be lightly taxed, these are attributable more to the high administrative cost of taxing agricultural income than to the political influence of this group.

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1 Lipton (1977), p. 273.

2 Ibid., p. 279.

While the relatively heavier taxation of the agricultural sector is common to "almost all poor countries", very little concrete evidence is produced in support of the hypothesis. The statement that "on the evidence of those few poor countries with available data, agriculture and the rural sector are overtaxed by all the criteria that can be sensibly be applied to tax policy"[1] is not substantiated with reference to empirical estimates of tax burdens for these specific countries.

The many empirical studies on tax incidence for India, one of the few countries with substantial literature on the subject, are either not mentioned or brushed aside on the grounds that they do not incorporate the impact of non-tax policies or that they ignore the differences in ability to pay in the two sectors. There may be some controversy, both at the conceptual and empirical level, over the question of aggregate sectoral tax burdens in the Indian economy.[2] However the evidence on tax incidence by income classes for the two sectors points conclusively to the presence of horizontal inequity in favour of the rural rich.[3] It has been clearly demonstrated that the high income groups in the

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1 Ibid., p.271. .

2 Gandhi (1966); Krishna (1972); Mathew (1968); Mitra (1963); Shetty (198).

3 Gandhi (1966); Krishna (1972); Mathew (1968).

rural sector have borne a significantly lighter tax burden than their urban counterparts.

While ignoring these carefully researched studies, Lipton criticises in great detail the following statement taken from a report of the Pakistan Taxation Commission. "The third aspect of the structure of taxation in Pakistan is the inadequate taxation of the agricultural sector. Agriculture constitutes the largest sector of the economy and claims about one half of the G.N.P. The contribution of agriculture to total tax revenue is estimated to be 27% excluding water rates and assuming that indirect taxes on agricultural products are shifted forward".[1] These statements are seen to epitomize the weak empirical basis of claims of under taxation of agriculture for a number of less developed countries.

Using the commission's figures for agriculture's share of total taxes and income levels in the two sectors and an arbitrary figure for subsistence requirements,[2] it is shown on the basis of some rough calculations that in fact the agricultural sector was overtaxed vis a vis the non farm sector when account is taken of the difference in taxable capacity of the two sectors. However since Lipton's own

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1 Government of Pakistan (1971), p.6.

2 Agriculture's share of total taxes is 27%; its share of income is 46.3%; agricultural population is 67% of total population; while subsistence requirements for the two sectors are assumed to be 30% of per capita income in 1968/69 (Government of Pakistan, 1971, p. 6.).

results are based on very rough approximations and arbitrary assumptions, they cannot serve as the basis of any valid conclusions regarding the adequacy of the level of agricultural taxation.

Here it should be mentioned that at another point of Lipton's study, his conclusions with respect to sectoral tax burdens for Pakistan are based on incorrect data. His deduction that the share of tax burdens in the Pakistan rural sector would be greater than its share of benefits derived from public expenditure is based on the fact that "some 27% of all taxation comprised direct taxes on agriculture".[1] The figure is inaccurate. Agriculture's share in tax revenues, including both direct and indirect taxes was estimated at 27% in the late sixties. The ratio of direct taxes on agriculture to total tax revenue was far lower at 3%. Even the figure for all direct taxes as a proportion of total taxes was lower at 22%.[2]

Other relatively more detailed attempts at measuring intersectoral tax burden for the Pakistan economy are reviewed in the next section.

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1 Lipton (1977), p.284.

2 Government of Pakistan (1971), p. 6.

Critical Review of Empirical Literature on Agricultural Taxation Policy in Pakistan

The empirical work on intersectoral tax burdens for Pakistan is limited to three studies, two of which pertain to the late sixties while the third estimate is for the year 1972/73. The case for or against higher agricultural taxation in these studies is based on the criteria of equity. Before proceeding to a critical evaluation of this research it is useful to outline the methodological framework generally used to compare tax burdens in accordance with the equity objective. Here it should be mentioned again that an equitable tax structure has to satisfy two conditions; the canon of horizontal equity which entails that units with equal taxable capacity be treated identically and the principle of vertical equity which necessitates that the tax burden should increase with the level of income according to some socially acceptable rate.

Tax burden is measured as the ratio of taxes, incorporating all taxes direct as well as indirect, to taxable capacity. Two different concepts are used to measure taxable capacity -- income per capita and income less subsistence requirements per capita. Due to problems, empirical and conceptual, in estimating basic subsistence levels the ratio of taxes to income per capita, although a less accurate concept, is the more widely used measure. However since the measure does not allow for any

progression in tax rates, it does not fulfill the requirements of vertical equity when comparisons between unequal economic units are involved. To remedy this limitation an alternate index was put forward by Frank.[1] Tax burden was now defined as the ratio of taxes as a proportion of income to income per capita. Hence in cases where income levels differed and the standard measure indicated equal sacrifice as reflected in the tax income ratio, Frank's index would slow a lower sacrifice for the higher income.

However this measure has been criticised by Gandhi[2] for giving an unduly high weight to income thereby incorporating "too much progression" justifiable only when there is an extremely large degree of dispersion in income levels. He suggested an improvement of the measure whereby the degree of progression was not fixed and could be specified in accordance with the variation in incomes being compared. The index was of the following form:

$B=t/y^{eo}$

where t is tax per capita

y is income per capita

eo represents the level of progression

Thus Frank's measure where eo=2 becomes a specific case of this general form. Gandhi used the value of eo=1.5 to

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1 Frank (1959).

2 Gandhi (1966).

represent the rate of progression appropriate for the level of disparity in rural and urban incomes in India. This value of eo has since been used in a number of more recent estimates of the sectoral distribution of tax burdens in the Indian economy.[1]

The few studies available for Pakistan display some variation in the methodological framework used for estimating sectoral tax burdens. Hamid's[2] assessment of rural-urban tax burdens relies mainly on a comparison of the ratio of direct taxes to income in the two sectors. The lower direct tax-income ratio in the farm sector is the basis of the study's conclusion that agriculture is under-taxed.

The distribution of indirect taxes between the rural and urban sector is estimated through an incomplete method. Data from the Household Income and Expenditure Survey is used to show the relatively higher per capita expenditure by urban households on excisable commodities such as sugar, tobacco, fats and oils as compared to their rural counterparts. This observation on the sectoral consumption patterns is considered sufficient to deduce a higher per capita contribution of the urban sector to indirect taxes. No attempt is made to systematically allocate indirect taxes between sectors incorporating

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1 Lipton (1978), p. 208.

2 Hamid (1970), p. 425.

not only differentials in per capita expenditure on taxed commodities by rural and urban households but the differences in sectoral populations as well. Finally Hamid's conclusion that agriculture bears a disproportionately small share of taxes is based on a comparison of average tax rates. Given the disparity in rural and urban incomes, the use of the measure neglects the norm of vertical equity which would require a higher tax rate on the relatively higher income sector.

An alternate estimate of sectoral tax burdens for the late sixties provided by Chaudhury[1] shows, contrary to Hamid's results for the same period, that agriculture was overtaxed in relation to it's capacity to pay. Chaudhury's estimates of the rural-urban breakdown of tax revenue rest on firmer empirical ground to the extent that the money burden of both direct and indirect taxes is incorporated. Indirect taxes are apportioned between sectors on the basis of a percentage derived in an IBRD report. According to this estimate[2] 27% of all indirect taxes are borne by the agricultural sector. On the assumption that there is no shifting of direct taxes, land revenue and water rates are assigned to agriculture while income and corporation tax are allocated to the non-agricultural sector.

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1 Chaudhury (1973).

2 World Bank (1969), p. 6.

Comparing the tax income ratios to the ratio of income per worker in the two sectors, the author concludes that agriculture is relatively over-taxed. The estimates reproduced in Table 5.1. show that whereas the income per worker ratio for non-agriculture to agriculture was as high as 163.5% and 179.2% in 1967/68 and 1969/70 respectively, the correspondingly tax income ratios were much lower at 138.06% and 137.3%. The measure of intersectoral equity used is based on Frank's method whereby tax burden is estimated as a ratio of tax as a proportion of income to income per worker. As mentioned earlier this method has been criticised for assigning too large a weight to income. Hence comparisons of tax burdens using this method would tend to over-estimate the relative sacrifice of the low income sector, in this case agriculture. In contrast to Hamid's study where comparison of sectoral tax burdens was based on the principle of proportional taxation, Chaudhury's assessment of relative burdens incorporates a greater degree of progression in tax rates than warranted by the differential in sectoral incomes.

Furthermore the classification of water rates as a direct tax on agriculture has been rightly criticised. As Qureishi[1] has pointed out water rates could only be considered

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[1] Qureishi (1973), p.434.

Table 5.1

Chaudhury's Estimates of Relative Income and Taxable Capacity

Sector	1967/68	1968/69	1969/70
A. Agriculture			
1. Total Taxes (million rupees)	1518	1785	2002
2. Income per Worker (rupees)	1631	1618	1765
3. Taxes as % of Income	10.85	12.67	12.80
B. Non-agriculture			
1. Total Taxes	2847	3418	4068
2. Income per Worker	2667	2862	2983
3. Taxes as % of Income	15.04	16.07	17.57
C. Disparity			
1. Income (B÷2) as % of (A÷2)	163.5	176.9	179.2
2. Taxes (B÷3) as % of (A÷3)	138.6	126.8	137.3

Source: Chaudhury (1973), p.105.

Table 5.2

Adjusted Estimates of Relative Income and Taxable Capacity

	1967/68	1968/69	1969/70
A. Agriculture			
1. Total Taxes (million Rs.) Chaudhury s Estimates (Alternative I)	1518	1785	2002
2. Total Taxes (million Rs.) Less Water Rates (Alternative II)	1278	1490	1655
3. Tax per Worker (Rs.) (Alternative I)	176.9	205	255.8
4. Tax per Worker (Rs.) (Alternative II)	148.9	171.1	186.6
5. Income per Worker (Rs.)	1631	1618	1765
B. Non-Agriculture			
1. Total Taxes Chaudhury s Estimate	2847	3418	4068
2. Tax per Worker			
3. Income per Worker	400.8	460.1	523.6
C. Disparity			
1. Relative Tax Payments Alternative I (A-3) ÷ (B-2)	.44	.44	.43
2. Relative Tax Payments Alternative II (A-4) ÷ (B-2)	.37	.37	.36
3. Relative Income per Worker (A-5) ÷ (B-5)	.61	.57	.59
4. Relative Income Allowance for Progression eo=1.5	.48	.43	.453

Source: Data for Water rates is taken from Qureishi (1973), p.436; the remaining data is taken from Chaudury (1973), p.105.

a tax if the government charged a higher price than the marginal cost of supplying water. Comparing data on marginal cost, marginal value of water and level of water rates,[1] he shows that the rates, on the contrary, involve a considerable degree of subsidy. Thus it is totally unjustifiable to classify them as a tax.

Excluding water rates from Chaudhury's estimates of total tax payments of the rural sector, the sectoral tax burdens are compared on the basis of Gandhi's measure. The results presented in Table 5.2. indicate that agriculture was paying less in taxes than was justified by the difference in the level of sectoral incomes. Thus in 1967/68 whereas the tax payments by the farm sector were 34% of the taxes paid out by the non-farm sector, the ratio of average farm incomes to average income in the non-agricultural sector, incorporating a certain level of progression, was substantially higher at 48%. Similarly for the other two years, the results reveal that the ratio of relative tax payment for agriculture to non-agriculture was consistently lower than the corresponding ratio of incomes adjusted for progression.

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[1] This information is taken from a study by Falcon and Gotsch (1966) where irrigation charges are estimated at Rs. 0.4 per acre inch, value to farmers often exceeds Rs. 5 per acre inch, while the long run cost of supplying water is calculated as Rs. 2 per acre inch. The value of total subsidy on water use, assessed as the difference between long run marginal cost and government receipts, comes to Rs. 900 million for 1968/69.

The usefulness of studies, such as those discussed above, where the case for increased taxation of agriculture is based on grounds of intersectoral equity has been questioned by recent writings on the subject. It is argued that the approach does not present a comprehensive picture of intersectoral burdens since it ignores the great many government policies which affect transfer of resources between sectors through non-tax measures such as foreign exchange policy, price policy, etc.

In the context of Pakistan the system of multiple exchange rates was considered the major instrument used to maintain unfavourable prices for farm products. Under this system the earnings of agricultural exports were assessed at the artificially low official exchange rate while industrial exports received a more favourable rate. Industrialists could also import their machinery requirements at the cheaper official rate.

The few empirical estimates of resources transfers attributable to non-tax policies, for the late sixties provide contradictory results. Hamid[1] has quantified the resource flow attributable to price policy as the difference between disguised taxes on agricultural output and subsidies on inputs.

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1 Hamid (1970), p. 430.

Disguised taxes are estimated as the difference between world prices of farm output at the scarcity and actual exchange rate, while subsidies to the sector include direct subsidies as well as indirect subsidies through underpricing of public utilities such as irrigation water. His results show that implicit and direct subsidies to agriculture outweighed the net effect of disguised taxes, leading to a net transfer of Rs. 1150 million in favour of agriculture in 1968/69.

An alternate estimate is provided in a World Bank Study[1] of a net outflow from agriculture to the amount of Rs. 500-900 million in 1969/70. However the emphasis on world prices as a benchmark for measuring the level of resource outflow/inflow attributable to price policy has underplayed the impact of changes in domestic terms of trade during the period on the intersectoral transfer of resources. The terms of trade moved in favour of agriculture throughout the sixties yet their impact on the transfer of resources has not been incorporated in either estimate. Hence on the basis of available evidence no conclusive statement can be made on the direction and magnitude of resource flows in the mid and late sixties through non-tax policies.

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[1] World Bank (1969), pp. 9-10.

The devaluation of the Rupee in May '72 ended the discriminatory treatment of agricultural exports. Procurement prices of major crops were raised four times in the five years from 1972 to 1977. Agriculture's terms of trade registered a sharp increase during the period. In view of these developments the argument that non-tax policies work to the detriment of the farm sector can no longer be considered relevant.

The other more basic objection to the measurement of equity in taxation at the sectoral level has been put forward by Krishna.[1] The concept of "intersectoral" equity is considered meaningless and of no functional singificance as only "the magnitude of the income of real tax paying units is relevant for equity; the nature of the particular activity or sector from which the income is derived is unimportant".[2] It is superfluous to go into the question of sectoral burdens. Inequity in the tax system can be demonstrated if "fiscal authorities have failed to tax various income brackets in the sector at the same rate as those brackets are taxed in other sectors. The deficiency if it exists, as it does in India at present, can be pointed out without any reference to the redundant concept of intersectoral equity. For it is a simple instance of horizontal inequity".[3]

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1 Krishna (1972).

2 Ibid., p. 1589.

3 Ibid., p. 1589.

In this context a valuable contribution to the analysis of tax incidence is made by Jeetun's study which provides the only estimates of inter-class tax burdens by the rural and urban sector for the Pakistan economy in the seventies. Comparison of tax burdens between classes is made on the basis of average tax rates, a perfectly appropriate method when comparisons between equal incomes are involved. The results presented in Table 5.3 indicate that the higher income groups

Table 5.3.

Effective Tax Rates by Income Classes in the Urban and Rural Sector -- 1972/73

	URBAN				RURAL			
Income Classes (Rs.)	% of House-holds	Share of Income	Share of Taxes	Effect-ive Tax Rate	% of House-holds	Share of Income	Share of Taxes	Effect-ive Tax Rate
Less than 200	27.68	9.32	4.43	8.19	51.91	28.73	26.33	7.81
200-499	54.30	38.26	20.80	9.38	42.29	48.29	47.26	8.34
500-1499	13.73	23.44	18.63	13.71	4.36	12.52	13.32	9.07
1500 and above	4.29	28.98	56.14	33.42	1.25	10.46	13.09	10.66
All Classes	100	100	100	17.25	100	100	100	8.52

Source: Jeetun (1978), p. 52.

in the farm sector are not only greatly under-taxed vis a vis their urban counterparts but also vis a vis the low income rural households. The predominance of indirect taxes had led to a very low level of progressivity of the rural tax structure reflected in the smaller degree of variation of effective tax rates over income classes in the sector. While the effective

tax rate in the urban sector varies from a low of 8.19% to a peak of 33.42%, the corresponding tax rates for the rural sector vary from 7.8% to 10.66%. Hence the presence of horizontal inequity to the advantage of the rural sector is specially marked for the highest income groups. The average tax rate for this class in the urban sector is more than three times the rate on the comparable income group in the rural sector. Here it needs to be emphasised that Jeetun's estimates refer to the rural and urban sector as opposed to the agricultural and non-agricultural sector. If the distribution of income in the farm sector is more skewed than that of rural income, which is very likely given the extreme concentration of resources in the country side,[1] the disparity in the tax burden by size classes will be higher in a comparison between the agricultural and non-agricultural sector.

A drawback of these estimates is the exclusion of provincial taxes and thereby land revenue, the major direct tax on agriculture, from the calculations. Since land revenue, a proportional tax, has far greater impact on low income groups it's omission would mainly effect comparisons of effective tax rates for the lower strata of the urban and rural sector: especially since the low income groups in the urban sector are not liable to any direct tax payments. In the case of

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[1] Evidence on the high concentration of land resources based on landownership data for 1976 is provided by Khan (1981, pp. 70-71).

high income groups the incorporation of land revenue would only lead to a marginal reduction in the differential in tax burdens. As Jeetun points out "even if we allocate total receipts from land revenue to the top two rural income classes which is undoubtedly an extreme assumption as other classes also pay this tax the differential in effective rates between the two sectors will be narrowed by five points but the effective rate in the rural sector will still only be half of the urban sector for those two classes".[1]

It is necessary to point out that these results, if anything, understate the differential in tax burdens between the two sectors due to the fact that Jeetun has allocated a far larger proportion of taxes to the rural sector than would have been justified under more realistic assumptions on the shifting of various taxes.

Jeetun's estimate of the incidence of indirect taxes by sectors is based on the assumption that taxes on all commodities are shifted forward to the final consumers. Hence the yield of each commodity tax is allocated between the two sectors in direct proportion to their respective expenditure[2] on the taxed item. In case of taxes on intermediate and capital goods, distribution of revenue is based on the ratio of sectoral

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1 Jeetun (1978), p. 55.

2 Data on consumption expenditure is taken from the Household Income and Expenditure Survey 1971/72.

expenditures on all manufactured goods. With respect to direct taxes, the income tax is assumed not to be shifted while fifty percent of the corporation tax is shifted forward to consumers. Finally the incidence analysis is limited to federal taxes only.

Estimates, derived in the study, on the share of the rural and urban sector in total tax revenue are presented in Table 5.4. show that the contribution of the urban sector in total tax revenue is 53.8% as compared to the figure of 46.12% for the rural sector. With respect to indirect taxes, the urban component at 44.27% is even lower than the corresponding rural share of 55.73%. These results differ dramatically from those of an earlier study[1] according to which the rural contribution to indirect taxes was substantially smaller at 27% of the total.

The reliability of Jeetun's estimates depends on the validity of his assumptions on the shifting of various taxes in the context of the Pakistan economy. On the basis of available empirical evidence[2] on the shifting of indirect taxes for Pakistan and certain characteristic of the country's corporate sector, it is felt that the assumption of the shifting of indirect and corporation taxes are of questionable relevance

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1 World Bank (1969). p. 6.

2 Mohammed (1978); Naqvi (1975).

Table 5.4

Share of Rural and Urban Sectors in Federal Tax Revenue Jeetuns Estimates

Type of Tax	RURAL		URBAN	
	Amount (Rs. Lakhs)	Share	Amount (Rs. Lakhs)	Share
Personal Income Tax			8707.0	100.00
Corporation Tax	806.2	32.52	1693.8	67.75
Excise Duties	12766.5	51.82	11868.2	48.18
Import Duties	9723.8	60.49	6352.2	39.51
Sales Tax	2813.3	59.97	1877.7	40.03
Direct Taxes	806.2	7.19	10400.8	92.81
Indirect Taxes	25303.6	55.19	20098.1	44.27
Total Taxes	26109.8	46.12	30498.9	53.88

Source: Jeetun (1978), p.23.

and have led to an over-estimate of agriculture's contribution to total taxes. Furthermore the Jeetun study is limited to the incidence of federal taxes. Although federal taxes constitute the major portion of tax revenues, provincial taxes incorporate the only direct tax on agriculture. Hence to get a complete picture it would be useful to look at the distribution of both federal and provincial tax revenue.

Finally Jeetun's findings pertain to the rural and urban sector while the objective of this thesis is to assess tax policy within the wider problem of the transfer of resources between the farm and non-farm sector. In this context a more relevant classification of tax incidence would be by the agricultural and non-agricultural sector. Available data does not permit an estimate of inter-class incidence by the farm and non-farm sector, however it is possible to derive the incidence of taxes by the functional classification of sectors. To this we now turn.

Alternate Estimate of the Contribution to Tax Revenue by the Agricultural and Nonagricultural Sectors

An attempt is made in this section to estimate the share of the agricultural and non-agricultural sector in both

federal and provincial taxes on the basis of more appropriate assumptions on tax shifting covering the period from 1972/73 to 1976/77.

In keeping with the general view in fiscal theory that direct taxes are difficult to shift, it is assumed that direct taxes are borne by persons on whom they are imposed. Accordingly land revenue and it's various surcharges are assigned to the agricultural sector and the personal income. tax to non-agriculture.

The incidence of the corporation tax has been a subject of considerable controversy. Despite numerous studies for developed countries the question of shifting is still not decided at either the theoretical or empirical level. In the context of India, Gandhi[1] has put forward a strong case for the view that the burden of this tax rests with the business sector.[2] The major point in the argument is the condition that under monopoly situations, characteristic of Indian industry, a tax on profits is seldom shifted as the monopolist always charges the maximum price. A high degree of monopoly, attributable to a number of factors such as limited competition, licensing of new capacity etc., is characteristic of the Pakistani business sector as well.

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1 Gandhi (1966).

2 The assumption that the corporation tax is not shifted is accepted in nearly all other more recent empirical work on tax incidence in India (Gandhi, 1966, pp. 44-49; Shetty,1971, p. 230) and the studies by Hamid (1970) and Chaudhury (1973) for Pakistan.

A recent study[1] shows that the nationalization of basic industries by the Bhutto government and the loss of assets in East Pakistan have made very little impact on the degree of concentration in the Pakistan industry. Hence for the purpose of this study the revenue from the corporation tax is allocated entirely to the non-agricultural sector.

Although there is no direct empirical evidence on the incidence of the corporation tax, there are some studies[2] on the shifting of indirect taxes in Pakistan for the early seventies. The findings of both the studies are very similar and show that whereas taxes on consumer goods are likely to be shifted almost fully to consumers, taxes on intermediate products display a very low degree of shiftability. On the basis of these results, revenue from indirect taxes on intermediate products is assigned to the non-agricultural sector while the yield of taxes on final products is divided between the farm and non-farm sector in proportion to their total expenditure on various taxed items. Details on the procedure applied to calculate total sectoral expenditure on various commodities are provided in the appendix.

Finally, export duties assumed importance as a source of revenue following the '72 devaluation when they were imposed

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1 Amjad (1976), p. 275.

2 Jeetun (1978); Mohammed (1978); Naqvi (1975).

to siphon off windfall profits accruing to exporters as a result of the sharp increase in their exchange earnings. It seems likely that the tax would have been passed on to the foreign buyers due to two reasons. Firstly, because of the devaluation the increase in domestic prices would not be fully reflected in world price and secondly the period under consideration was marked by a boom in the demand for primary products in the international market. Furthermore from 1974/75 onwards as a result of the subsequent slump in the world market the export duties were removed from most commodities. Hence it can safely be assumed that the domestic producers did not bear the burden of these duties.

Data on taxes are taken from various issues of the Explanatory Memorandum on the Budget, Public Finance Statistics and Federal Tax Administration Report. Information on the methodology used for allocating various other central and provincial taxes (wealth taxes, estate duty, stamp and registration etc) between agriculture and non-agriculture is given in the Appendix.

Estimates of incidence of direct, indirect and total taxes by the farm and non-farm sector are presented in Table 5.6. The results indicate that despite the larger agricultural population the share of the farm sector in tax revenues was

Table 5.5

Share of Direct and Indirect Taxes in Agricultural and Non-Agricultural Tax Revenues

(rupees lakhs)

AGRICULTURE

	Direct Tax	%	Indirect Tax	%	Total
1972/73	1859.42	14.8	10742.09	85.2	12601.51
1973/74	2263.3	9.8	20705.65	90.1	22969.48
1974/75	2501.7	8.9	25451.97	91.1	27953.67
1975/76	2864.6	8.3	31538.57	91.7	34403.17
1977/78	1794.2	4.9	34538.45	95.1	36332.65

NON-AGRICULTURE

	Direct Tax	%	Indirect Tax	%	Total
1972/73	13375.58	26.1	37895.91	73.9	51271.49
1973/74	15297.36	24.4	47515.35	75.6	62812.71
1974/75	16103.3	18.0	73506.03	82.0	89609.33
1975/76	24381.4	21.6	88739.43	78.4	113120.83
1977/78	28065.8	21.0	105788.55	79.0	133854.35

Source: Data on taxes is taken from various issues of Explanatory Memorandum on the budget, Public Finance Statistics, and Federal Tax Administation Report; information on weights used to allocate taxes is provided in the Appendix.

Table 5.6

Incidence of Direct, Indirect and Total Taxes by the Agricultural and Non-Agricultural Sectors. 1972-1977

(rupees lakhs)

	DIRECT TAXES*				INDIRECT TAXES			
	Agr		Non-Agr		Agr		Non-Agr	
	Amount	Share	Amount	share	Amount	share	Amount	Share
1972/73	1859.42	12%	13375.58	88%	10742.09	22%	37895.91	78%
1973/74	2263.83	13%	15297.36	87%	20705.65	30%	47515.35	70%
1974/75	2501.7	13%	16103.3	87%	25451.97	26%	73506.03	74%
1975/76	2864.7	11%	24381.4	89%	31538.57	26%	88739.43	74%
1976/77	1794.2	6%	28065.8	94%	34538.45	25%	105788.55	75%

TOTAL TAXES

	Agr		Non-Agr	
	Amount	Share	Amount	share
1972/73	12601.51	20%	51271.49	80%
1973/74	22969.48	27%	62812.71	73%
1974/75	27953.67	24%	89609.33	76%
1975/76	34403.17	23%	113120.83	77%
1976/77	36332.65	21%	133854.35	79%

*Direct taxes on agriculture include land revenue, surcharge on land revenue, motor vehicle tax, wealth tax, and estate duty.

Source: Data on taxes is taken from various issues of Explanatory Memorandum on the budget, Public Finance Statistics, and Federal Tax Administation Report; information on weights used to allocate taxes is provided in the Appendix.

lower than that of the non-farm sector for the entire period varying between a low of less than 20% of total tax revenue in 1972/73 to a high of nearly 27% of total taxes in 1973/74. The smaller share of agriculture is attributable to the lower per capita income and the relatively lower consumption expenditure on high tax items such as petroleum products etc., while a much larger percentage of expenditure is devoted to food items which are exempt from taxation. Also intermediate inputs, such as fertilizers and agricultural machinery are imported duty free.

Further disaggregation of the farm and non-farm share of taxes into their direct and indirect tax components is presented in Table 5.5. The estimates not only reveal a greater degree of dependence on indirect taxes in the agricultural tax structure but also show that the reliance on indirect taxation has increased substantially in both sectors during the period under study. There was a relatively moderate increase in the case of non-agriculture where the indirect tax component of total taxes increased from 74% to 77% between 1972/73 to 1976/77. In the farm sector the share of indirect taxes in total taxes paid by agriculture increased from 85% in 1972/73 to 95% in 1976/77 with the share of direct taxes falling to a mere 5% of the total revenue collected from the sector. The disproportionately

small share of direct taxes in agriculture and the sharp reduction over time underlies the rigidity of the land revenue system and "agricultural income tax" (which is no more than a surcharge on land revenue), the two major direct taxes on agriculture.

Unfortunately due to the lack of data on household income and expenditure patterns for the years under study,[1] it is not possible to estimate the inter-class tax burdens for the agricultural and non-agricultural sectors. Available information permits a rough measure of sectoral tax burdens, however it is felt that this statistical exercise will not yield any useful information. As Krishna[2] has convincingly argued, the desirability of higher taxation of agriculture from the viewpoint of distributional criteria has to be assessed in terms of it's impact by income classes rather than by sectors.

In any case the results of Jeetun's study and the estimates derived above indicate clearly that it is the higher income group of rich farmers rather than the rural sector as a whole which is grossly undertaxed due to the virtual absence of any effective system of direct taxation on the sector.

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1 The latest year for which this data was available was 1971/72 in the Household Income and Expenditure Survey which was the basis of Jeetun's study.

2 Krishna (1972).

While the question of an agricultural income tax has become a point of great contention, the various governments have not hesitated to tax the rural sector through indirect taxation despite the negligible progressivity of the rural tax structure. The tendency of an increased reliance on indirect taxes over time, characteristic of both sectors, was specially noticeable in the case of agriculture. As shown in Table 5.6. the dependence on indirect taxes in the rural tax structure has increased substantially over time. By the end of the Bhutto period 95% of the tax revenue collected from the farm sector was in the form of indirect taxes.

The inequities inherent in the tax structure are all the more glaring in view of the fact that it is this class of farmers who have been the major beneficiaries of the agricultural policies of successive governments that have ruled the country since the past two decades. Given the unequal access to resources in the countryside, policies such as subsidies on inputs (fertilizers, tractors etc.) have worked to the advantage of the wealthy farmers who have the capital and influence to avail of them. High procurement prices and the favourable movements in the terms of trade have further accentuated the income disparities in the rural sector by conferring disproportionate benefits to large farmers who market a greater share of their output.

Yet no attempt has been made to redress the negative distributional effects of these policies and to tap the windfall gains accruing to the rural elite through an effective direct tax on farm incomes.

Agricultural Taxation and the Objective of Domestic Resource Mobilization

Apart from equity considerations the revenue needs of the state required a more efficient system of taxing the income of the largest sector of the economy. The failure to realise this substantial potential is specially glaring in the context of the shortage of domestic resources which has consistently plagued the country's development programs. A problem which has been specially acute since the mid-sixties.

The growth policy pursued by the Ayub regime was predicted on the saving effort of the entrepreneurial class and large inflows of foreign aid. Fiscal policy was to provide incentives to attract private capital into industry through a variety of fiscal concessions and high tariff policies. In this context public savings were not expected to make any significant contribution to the savings rate and hence, the role of taxation as a mechanism for mobilizing resources in the public sector was of minor importance.

The strategy, however, failed to generate a high and rising saving rate. The only exception were the early years of the Second Plan which were marked by a tremendous increase in

Table 5.7.

Savings and Investment in the Pakistan Economy 1949-1970

Percent of GNP	1949/50	1959/60	1964/65	1969/70
Investment (gross)	3.5	8.9	18.3	13.5
Savings	2.2	6.1	11.7	9.7
F. Aid		2.8	7.2	3.6
Tax Revenue		6.1	8.2	8.2

Source: Government of Pakistan, Planning Commission, Fourth Five Year Plan, p. 8.

foreign aid. However, with the restriction in the foreign aid flow, subsequent to the '65 war, the domestic saving rate also fell sharply. In the event the government had no adequate response but to cut back on public sector outlay. Thus the actual expenditure in the public sector was only Rs 21750 as compared to the plan target of Rs. 30000.[1] Even this was achieved by borrowing abroad on harder terms and defecit financing at home. No attempt was made to come to terms with the inadequacy of the public resource mobilization effort. The ratio of taxes to GNP over the twenty year period from 1950 to 1970 rose by a mere two percentage points (Table 5.7).

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[1] Government of Pakistan, Planning Commission, Fourth Five Year Plan, 1970, p. 45.

The Bhutto period was characterized by a dramatic widening of the resource gap from a level of 3.5% of GDP in 1971 to 10.2% in 1976 (Table 6.24). The shift in government strategy to greater emphasis on distributional objectives was reflected in a sharp increase in public spending on social sectors, subsidies on food, on nationalized industries etc. Public sector development expenditure went up from 5.5% to 10.2% of GNP while non-development expenditure more than trebled during the period (Table 6.24).

However despite the professed difference in social and economic goals, the Bhutto government's approach to the problem of resource mobilization showed no significant departure from that of the earlier regime. The Pakistan economy continued to rely heavily on foreign aid to finance investment at more and more unfavourable terms. The level of deficit financing also accelerated sharply during the period, while no serious effort was made to restructure the tax system.

Tax revenue continued to stagnate at 11%-12% of GNP while the proportion of direct taxes to total tax revenue declined from 23% in 1971/72 to 14.2% in 1977/78 (Table 5.10). Due to low income levels and the large non-monetized sector, most developing countries find it difficult to raise revenue

Table 5.8

Share of Government Revenue in GNP of selected Countries, 1971-76
(percent)

COUNTRIES	TAX REVENUES		
	1971	1973	1976
Bangladesh	-	5.1	8.5
Burma	12.3	9.6	11.2
India	15.2	17.1	16.7
Korea	13.7	12.4	15.2
Malaysia	17.0	18.3	19.6
Pakistan	11.2	11.4	12.0
Phillipines	7.7	8.9	n.a
Singapore	13.4	14.1	14.4
Sri Lanka	16.4	18.0	19.1
Thailand	12.0	13.1	n.a
Average for above countries	13.2	12.8	

Source: "A Comparative Study of Fiscal Development in the Developing Member Countries of Asian Deveopment Bank," ADB Staff Paper No.9; Government Finance Statistic Yearbook, IMF.

Table 5.9

Comparison of Pakistan's Tax Structure with Other Developing Countries - July, 1971

Tax	Pakistan		LDC s with per capita income between 100-200 dollors	
	Shares of Tax Revenue	Tax/GDP Ratio	Share of Tax Revenue	Tax/GDP Ratio
Income Taxes	14.25	1.7%	19.6%	2.6%
Taxes on International Trade	41.2%	5.2%	33.4%	4.4%
Taxes on Production and sales	40.8%	2.8%	33.8%	4.5%
Taxes on Property	0.4%	-	2.0%	0.3%
Pay-Roll Taxes	-	-	3.7%	0.5%

Source: Raja.J.Chelliah, "Recent Trends in Developing Countries," IMF Staff Paper, July 1971.

Table 5.10

The Changing Composition of Federal Tax Revenue in Pakistan

Nature of Tax	1960/61 Tax (Rs. mil)	1960/61 Share	1971/72 Tax (Rs. mil)	1971/72 Share	1977/78 Tax (Rs mil)	1977/78 Share	Annual Compound Growth Rate
A. Direct Tax	322	22.8	1267.2	23.0	2733.2	14.2	13.3
1. Income Taxes	319.6	22.6	1236.4	22.5	2654.7	13.8	13.3
2. Others	2.8	0.2	30.8	0.5	78.5	0.4	21.7
B. Indirect Taxes	1089.3	77.2	4426.4	77.0	16558.5	85.8	17.4
1. Custome Duties	438.8	31.1	1312.2	23.9	7944.6	41.2	17.0
a. Import Duties	413.3	29.3	1170.7	89.2	7859.6	40.7	18.9
b. Exoprt Duties	25.5	1.8	142.5	10.8	5.0	0.5	7.3
2. Excise Duties	288.1	20.4	2119.1	38.6	6184.0	32.0	20.1
3. Sales Tax	362.4	25.7	481.5	8.8	1614.4	8.4	9.2
4. Surcharge	-	-	313.6	5.7	815.5	4.2	-
C. Total Taxes	1411.7	100	5493.6	100	19291.7	100	16.6

Source: Jeetun, The Federal Tax System in Pakistan: An Overview, Discussion paper No.33, Applied Economics Research Centre, Sepetember 1978, p.3

through direct taxes. However, a comparison with tax effort for other countries at a similar level of income (Table 5.9) indicates clearly that Pakistan's poor performance cannot be attributed to a lower level of development. Thus while income tax comprised 14.2% of tax revenue for Pakistan, the average figure for a select sample of less developed countries was much higher at nearly 20%.

Furthermore empirical research on the tax system reveals a highly inelastic structure with very low responsiveness of tax yields to changes in output and prices. The elasticity of total taxes was considerably below unity at .776 whereas the elasticity of direct taxes was even lower at only .496.[1] Due to the inelasticity of the revenue structure, a substantial tax effort in the way of new taxes, comprising nearly half the icnrease in tax revenues each year from 1972-77, was required to prevent the tax GNP ratio from falling.

Failure to tax agricultural income has been singled out in various government reports as one of the principal causes underlying the meagre contribution of direct taxes to revenue as well as the inelasticity of the tax system. Thus in the words of the planning agency: "If we have a tax system in which the sector constituing roughly half the GNP and expected to grow rapidly is bearing a tax burden which is

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[1] Jeetun (1978a),p. 16.

fixed in money terms and cannot change automatically with increasing incomes, it is difficult to conceive of an elastic tax system".[1]

The urgent need to tap the surplus in the largest sector of the economy through a reform of the agrarian tax structure has also been reiterated in nearly every official document related to the subject. The report of the Taxation Commission of 1959, the first thorough inquiry into the country's tax structure, stated clearly that the agricultural sector was inadequantely taxed both on the basis of equity and in terms of revenue requirements of the development plan. "The separate tax treatment of incomes originating from agricultural and non-agricultural sources militates against the fundamental concept of income taxation which requires that an individual's capacity to pay tax should be determined with reference to his total income from all sources. The present distinction results in undue sacrifice of revenue and is ill suited for a country whose economy is mainly agricultural".[2] Brushing aside objections of administrative inconvenience, the committee strongly recommended that the present system of levy surcharges on land revenue be abolished and replaced by a proper tax on agricultural subject to a a progressively rising rate.

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1 Government of Pakistan, Planning Commission, (1970), p. 55.

2 Government of Pakistan, (1960), p. 31.

The case put forward by the commission was further strengthened by the tremendous productivity gains in agriculture from the early sixties onward. Thus the following statement from the Third Plan: "some ways and means must be devised to capture some of the increase in agricultural income in the form of taxes particularly because agricultural incomes are expected to increase during the Third Plan. There was some justification for not raising the burden of agricultural taxation in the fifties due to it's virtual stagnation but with the high rates of growth achieved in the sector during the Second Plan period the picture has changed dramatically".[1]

While nothing tangible was done, the tendency to stress the importance of fiscal reform in agriculture in official pronouncements continued into the Fourth Plan. "Present rate of tax revenue to GNP in Pakistan is the lowest in the world. Reform of the old agricultural system is urgently needed either through a graduated land tax or by extending the principles of income tax to agriculture".[2]

Reforms of the Land Tax Structure

Not only was there no attempt to bring agriculture under the sphere of income tax legislation but also there was no

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1 Government of Pakistan, Planning Commission (1965), p.71.

2 Government of Pakistan, Planning Commission (1970), p.55.

serious effort made to institute any effective reforms of the outmoded land tax structure.

The land revenue system, the only direct tax on agriculture, is regressive and highly inelastic with respect to changes in output and prices. The inflexibility of land revenue receipts is attributable to the prevalence of a fixed assessment system. With the exception of the sliding scale system which was applicable in some parts of Sind, the land revenue liability of each landholder is fixed in money terms at the time of settlement and remains so fixed for the duration of the settlement. Furthermore the increase in tax incidence under a new settlement is limited to 25% of the previously assessed demand. This restriction along with the long intervals between settlements has led to the decreasing share of the state in agricultural income to much less than the legal limit of twenty five percent of net assets. A government commission[1] noted that in twenty nine out of the total of forty one districts the operative settlement in the late sixties had been concluded prior to independence and of these sixteen pre-dated World War II. Even in more recent settlements because of the 25% ceiling on increase in assessed demand, the land revenue burden has fallen far behind the sharp increases in productivity and prices.

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1 Government of Pakistan, Interim Report of the Taxation Commission, (1971), p.40.

Until 1975 the revenue collected varied little with size of landholding. The "agricultural income tax" whose contribution to provincial revenue has been negligible is the nature of a surcharge on land revenue. Since it is proportional to land revenue the yield of this tax has also remained fixed.

The 1959 Tax Commission had recommended some reforms of the land tax system with a view to making it a more flexible source of revenue. The most important of these was that a sliding scale system, which would allow the revenue liability to vary with price changes, be adopted instead of the present fixed assessment system. The commission also suggested a reduction in the period of settlement from thirty to fifteen years. None of these reforms were implemented.

However, seven years after the report some minor cosmetic reforms of the land revenue system were enacted. The period of settlement was reduced from thirty to twenty-five years. An ad hoc increase of 25% over the basic rate of assessment applicable at the time was announced and adopted in 1969.[1] This brought about only a token change in revenue demand since the assessed value of assets was unchanged. As mentioned earlier this value was based on settlements which had been

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[1] Government of Pakistan, Land Revenue Rates in West Pakistan (1969).

enacted before partition or earlier and in no way reflected the sharp increase in actual value of net assets since then.

Bhutto's government introduced some further reforms of the land revenue system. In 1972 the sliding scale system in effect in some areas of Sind was replaced by a flat rate system fixed on the basis of produce index units.[1] The Sind government also instituted a graduated surcharge on land revenue similar to the "agricultural income tax" of Punjab aimed at incorporating a degree of progression into the system.[2] These surcharges based on a flat revenue rate were not likely to impart progressiveness to the system. If anything these changes made the system more rigid and inequitable than before. Firstly, they ended the flexibility of revenue demand with respect to prices. Secondly the flat rate was based on produce index units which grossly under-stated the actual productivity of land.

In 1975, Bhutto announced the exemption of small landowners (with holdings under 12 acres of irrigated and 25 acres of unirrigated land) from land revenue. At the same time all landowners with holdings greater than 25 acres of irrigated and 50 acres of unirrigated land were liable to pay land revenue at an increased rate.[3] The fiscal impact of the reform amounted

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1 Government of Sind, Board of Revenue, Flat Rate Assessment in Sind (1975), Appendix I.

2 Ibid., Appendix VI, p. 58.

3 Amendment in the West Pakistan Land Revenue Act of 1967.

to a net loss of Rs. 26 million for the two provinces of Punjab and Sind which was 13% of the land revenue collected in these provinces prior to the reform.[1] Out of 8.68 million landholders, 7.65 million were expected to benefit from these reforms.[2] The small landowners were a major constituency of the PPP and these reforms were primarily meant to ensure their support while the large landlords were effected much less than would have been the case if a progressive direct tax had been adopted.

Meanwhile the proportion of direct taxes to income in the agricultural sector fell consistently over the period to the ridiculously low figure of .32% in 1976/77. At the same time the contribution of direct taxes on agriculture to provincial tax revenue which was 41% in 1964/65 declined dramatically to less than 11% in 1976/77 (Table 5.11).

It was clear that the very low elasticity and inequity of the tax structure could not be corrected by a mere revision of revenue rates and yet till 1977 the principle of income tax on agriculture stood rejected. Administrative infeasibility was the most often cited "official" explanation for the failure to impose an effective direct tax on agricultural income. Since the majority of the rural population was illiterate and could

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1 Khan (1981), p. 262.

2 Ibid., p. 262.

Table 5.11

Direct Agriculture Taxes as a Proportion of Income and Provincial Revenue - Selected Years, between 1960 and 1979

million rupees

Year	Direct Agricultural Taxes*	Agricultural Income	Total Provincial Taxes	Ratio of Direct Agricultural Taxes to Agricultural Income	Provincial Revenue
1960/61	135	8184	-	1.65	-
1964/65	154	10438	374	1.48	41.2
1965/66	165	10572	416	1.56	39.2
1966/67	154	12460	423	1.25	36.4
1967/68	169	13994	451	1.21	37.4
1968/69	172	14038	520	1.23	33.1
1969/70	172	15964	538	1.08	32.0
1970/71	138	16236	536	0.85	25.7
1971/72	155	17934	629	0.86	24.6
1972/73	164	21907	638	0.75	25.7
1973/74	147	28084	723	0.52	20.3
1974/75	194	33533	1163	0.58	16.7
1975/76	200	38338	1365	0.52	14.7
1976/77	140	43686	1308	0.32	10.7
1977/78	184	49370	1446	0.37	14.1
1978/79	210	56370	1491	0.37	14.1

Source: M.H.Khan, Underdevelopment and Agrarian Structure in Pakistan, 1981, p.272-273.

*Direct Agricultural taxes include land revenue and surcharge on land revenue.

not keep accounts, it was argued that a tax on agricultural income would stretch the administrative capabilities of the ill-equiped Income Tax Department to the breaking point.[1]

As far back as 1959 the Taxation Commission had considered and rejected this argument in the following terms. "We would point out that the exemption limit in terms of land holdings would exempt the small agriculturists from the necessity of maintaining separate accounts. Even in other cases the difficulty would not be more than what is felt by small retail shop-keepers in the urban areas. In their case as most of them do not keep acceptable accounts the income tax officer calculates their turnover and profit on the basis of general information available to him. Such a calculation would be much easier in agriculture because the yield and prices can be independently determined. In East Pakistan revenue authorities do use these indirect methods for calculating the income of the agriculturists where accounts are not produced for determining the liability under provincial Agricultural Income Tax",[2]

The other much publicised argument against imposing a

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1 Government of Pakistan (1960), p. 115.

2 Ibid., p. 115.

direct tax on agricultural income is the supposedly low yield potential of the measure. However this view is effectively countered by empirical estimates of an income tax on agriculture provided in a study by Khan.[1] The results show clearly that the tax would not only fulfil equity objectives but would also be capable of generating substantial revenue.

On the basis of alternative assumptions about net farm income,[2] Khan derives three sets of estimates of potential revenue from the agricultural income tax. The tax rates used in the study are much lower than those applicable to non-farm incomes. The author demonstrates that even the most conservative estimates, based on income data from low productivity districts like Rahimyar Khan for Punjab and Hyderabad for Sind, yield considerably higher revenues than those collected from agriculture in recent years in the form of direct taxes. The minimum estimates of the agricultural income tax for 1972/73 is nearly six times the value of land revenue and it's surcharge and one and a half time the value of all provincial taxes for the year.

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1 Khan (1978).

2 Data on net farm incomes by farm size is taken from a sample survey of 752 farmers from nine districts of Sind and Punjab in 1972/73. Information on cultivated area is taken from the 1972 Census of Agriculture.

No credible case can be built for maintaining the existing agrarian tax structure. The only beneficiaries of the system are the class of wealthy landowners. It was a widely accepted fact that the real obstacle to agricultural taxation lay not in administrative difficulties or other economic rationale but in the stronghold of the landed elite on the power structire of the country. Their interests were well represented at every level of government in all the regimes that have ruled Pakistan. The failure to impose an effective direct tax on agriculture was just one aspect of the subservience of public policy to the demands of this powerful landlord lobby.

In March '77 Bhutto announced the reform of the agricultural tax structure.[1] The land revenue system was abolished. All landowners with holdings of up to 25 acres were entirely exempt from direct taxation. For the rest of the landowning population agricultural income was to be taxed at the same rates applicable to the non-farm sector. Generous deductions were allowed on gross income for working capital in the form of seeds, fertilizers, wages, interest etc. Full deductions were also allowed for the cost of agricultural machinery such as tractors, tubewells, other farm implements as well as land development and levelling. Gross income was

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[1] Finance Supplementary Act, 1977, Vol.29, pp.418-425.

estimated by a simple accounting procedure as some multiple of produce index units. The various deductions combined with the accounting method held considerable incentive potential for the modernization of agriculture.

The reform on the one hand provided further encouragement to capitalist farming while on the other hand it augumented the revenue needs of the government. The state urgently needed to expand it's resource base. Exemption from land revenue for small farmers announced in 1975 had led to a net loss to the public exchequer despite the upward revision in the rates for the middle and large landholders. This was at a time when the government was having a severe crises in mobilizing resources for it's public sector program.

However the timing of the announcement just two months before the March elections indicated that the reform was primarily motivated by political considerations. Bhutto wanted to ensure the support of his rural constituency of the poorer strata of the sector. The exemption of landowners with holdings under 25 acres would according to one estimate, confer benefits to 91% of the country's peasantry owning over half of the cultivable area in Pakistan.[1] Not to mention the fact that the decision removed the peasants from under the influence of the corrupt local revenue officers.

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[1] Ahmed (1978), p.489.

Furthermore the question of an income tax on agriculture had tremendous implications in the context of Pakistan. The failure to tax farm income was widely attributed to the political influence of the landed gentry. Bhutto's tax reform was an effective means of countering the growing impression that the Peoples Party had become a vehicle for large landlords and no longer represented the interests of the less priviledged groups.

However the reform did not reflect any diminution in the importance of the support of the landed elite to the ruling party. It was very much in keeping with Bhutto's policy towards the landlords as well as the other power blocs. While their independent influence was undermined, there were various compensations to assure continued support. Hence while the agricultural income tax was an encroachment on their priviledged position, at the same time there were enough loopholes in the form of deduction and exemptions to ensure favours to loyal supporters. Besides loyalty would be well rewarded in the form of other benefits, in the form of the input subsidy and price program to ensure the support of the landlord lobby.

The reform of the tax structure was never implemented. Bhutto was ousted from power by a military coup in July '77.

Another official committee was constituted in 1978 to examine the pros and cons of the new legislation. The committee concluded that there was no tax advantage to shifting to the agricultural income tax and the system of land revenue should be continued.[1]

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[1] Government of Pakistan, Report of the Committee on the Revitalization of Revenue Administration, 1978, pp. 12-13.

Appendix B

Distribution of the Burden of Indirect Taxes between the Agricultural and Non-Agricultural Sectors

The revenue from indirect taxes on consumption goods is distributed between the two sectors on the basis of total expenditure on the taxed commodity in each sector.

The Household Income and Expenditure Survey provides data on monthly consumption expenditure for rural and urban households on a number of commodities such as clothing, footwear, food, fuel and lighting and other miscellaneous items. Information from HIES 1971/72 (the latest available issue) is used in the calculations of intersectoral distribution of indirect taxes for the years 1972-1977 on the assumption that there was no significant change in the pattern of consumption expenditure during the period.

To derive total expenditure on taxed commodities by agriculture and non-agriculture a breakdown of rural and urban population by economic categories is required. The Labour Force Survey published by the Central Statistical Office provides data on self-supporting persons in various economic categories as a proportion of rural and urban totals. This information is used to estimate the agricultural and non-agricultural population in the rural and urban areas on the

assumption that the distribution of population between different economic categories is in the same ratio as that of self-supporting persons.

The total value of expenditure on individual products by the agricultural sector is derived by multiplying the per capita expenditure on the product in the rural and urban sector by the rural agricultural population and the urban agricultural population respectively and summing the totals. A similar procedure is used to derive the value of expenditure of the non-agricultural sector on various items.

The ratios of sectoral expenditures on various products are used to allocate taxes on items such as sugar, vegetable products, tobacco, tea, salt, clothing, footwear etc. Taxes on electrical goods were divided in proportion to the expenditure on electrciity in the two sectors. The sectoral expenditure on rent was the base for allocation of taxes on cement and paints and varnishes. The durable component of the expenditure on travelling was used to distribute taxes on vehicles while taxes on wood pulp, paper and stationery were divided on the basis of expenditure on education in the two sectors. In cases where it was not possible to identify expenditure categories of taxed items such as rubber products, plastic products. etc., the ratio of sectoral expenditure on miscellaneous items was used.

In case of petroleum products additional information provided in an official publication was used (Table B.2). Tax yields for this category were allocated on the basis of these estimates of petroleum consumption by sectors. The proportion of petroleum products for domestic use was further divided between the two sectors in the ratio of their expenditure on fuel and conveyance. Within the chemical products category taxes on industrial chemicals were assigned to non-agriculture (fertilizers are exempt from indirect taxation) whereas revenue from taxes on cosmetics and pharmaceutical products were distributed in the ratio of expenditure of the two sectors on medical andpersonal care.

Finally, taxes on iron and steel imports and machinery (agricultural machinery is imported duty free) were allocated to the non-agricultural sector.

Provincial Taxes: Revenue from Provincial Excise derived largely from intoxicants and alcoholic beverages was divided in the ratio of sectoral expenditure on miscellaneous food items.

Property and capital transactions involving nominal amounts have to bear registration and stamp fee. Assuming a direct relationship between transactions and income the burden of these taxes is distributed in the same proportion as income in the two sectors.

Other provincial taxes consist largely of taxes that fall on non-agriculture e.g. taxes on cinemas, hotels, urban immovable property tax, and profession tax etc. Hence only 10% of the yield of this category is assigned to agriculture.

Wealth Tax, Estate Duty, and Gift Tax: These taxes are characterized by high exemption limits and mostly fall on the very high income groups. Jeetun has derived the share in the rural and urban incomes of the highest income bracket, defined as the households earning Rs. 2000 or more per month, by adjusting H.I.E.S. data for the under-reporting of income of this class. Assuming an identical distribution of income in agriculture and non-agriculture, income accruing to this bracket in the two sectors is estimated. The revenue from the gift, wealth, and estate taxes is then divided in proportion to the ratio of the income of the richest strata in the farm and non-farm sector.

Table B.1

Share of The Agricultural and Non-Agricultural Sector in Total Expenditure on Various Commodities

Commodity	Share of Agriculture	Share of Non-Agriculture
Animal and Vegetable Products	.375	.625
Tea and Coffee	.49	.51
Sugar	.45	.55
Salt	.51	.49
Cigarettes	.32	.68
Misc. Food Items	.34	.66
Clothing	.52	.48
Footwear	.52	.47
Kerosene Oil	.42	.58
Electricity	.19	.81
Matches	.53	.47
Fuel and Light	.5	.5
Rent	.10	.90
Personal Care	.43	.57
Medical Care	.49	.51
Education	.33	.67
Travelling	.37	.63
Durable	.12	.88
Non-durable	.40	.60
Fuel, Light and Conveyance	.45	.55
Misc. Items	.47	.53

Table B.2

Sectoral Distribution of Petroleum Consumption (percent)

	1964/65	1973/74
Domestic	7.6	12.5
Industry	10.4	5.8
Agriculture	5.2	6.5
Transport	28.1	34.7
Power	1.0	5.4
Other Govt.	24.1	15.6
Export	21.6	19.5

Source: Government of Pakistan, Energy Yearbook, 1979

CHAPTER VI

ECONOMIC POLICIES AND PERFORMANCE: THE BHUTTO PERIOD

This chapter presents a detailed analysis of the impact of major policies undertaken by the Bhutto government on sectoral growth, savings, investment and distribution.

Agriculture: Government Policies and Growth Performance

A. Strategy of Agricultural Development

Despite its commitment to a new distribution oriented strategy the policies adopted by the Bhutto regime in agriculture displayed a remarkable similarity to those of his predecessors. Thus the land reform while more effective than Ayub's, was not aimed at a drastic redistribution of land resources and nor was his approach to the development of agriculture significantly different from the strategy that prevailed in the sixties.

As has been discussed in more detail elsewhere in this study, Bhutto's government did not reflect a diminution in the political power of the large landowners. On the contrary, the rural elite were heavily represented in the Peoples Party from its ascension to power. The leading feudal families flocked to join the party after the PPP victory in the '70 election. However unlike the preceding governments, the Peoples Party also had the support of the less priviledged strata in the countryside who had rallied

to Bhutto's promise of sweeping socio-economic reforms.

To satisfy the conflicting interests of the two major components of his support in the rural sector Bhutto enacted land reforms which on the one hand had tremendous symbolic impact while on the other hand their effectiveness was considerably reduced through various exemptions and further diluted through less than half hearted implementation.[1] Analysis of the main features of the reform and its limited impact on the distribution of land resources in the rural areas is provided in chapter 2. Here it need only be repeated that although a land reform was essential to establish the social legitimacy of the regime, a number of loopholes in the legislation as well as illegal ways of avoiding land transfers enabled the politically powerful class of large farmers to maintain land resources considerably above the official ceiling.

It is clear that the strategy for the development of the agricultural sector was not predicated on a redistribution of land and other resources. In keeping with the approach of previous regimes primary reliance was placed on a strategy of providing incentives to private investment in the sector. The major stimulus to growth was to come through the continued modernization and mechanization of the sector of large farms. Generous exemptions for mechanized farming provided in the land reforms, fifty acres per tractor or tubewell, set the stage

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[1] See Herring (1980), pp. 506-7.

towards this objective. The process was to be further facilitated by a dramatic increase in the supply of credit to the rural sector. Institutional credit to the sector increased dramatically from Rs. 80 million in 1971/72 to Rs. 415.2 million in 1973/74 and Rs. 637.9 million in 1976/77 (Table 2.2. Chapter 2). Credit from the government sponsored Agricultural Development Bank at very favourable interest rateswas the main source used to finance tractor imports (Table 2.3. Chapter 2). Furthermore, the nationalisation of commercial banks in 1974 gave the government greater control over their funds enabling the diversion of an increasing amount of credit to the farm sector. As a result, loans by commercial banks to agriculturists increased threefold from Rs. 85.7 million in 1972/73 to Rs. 286.4 million in 1973/74 (Table 2.2. Chapter 2).

The other major element of the development strategy in agriculture was the policy of subsidizing inputs and maintaining high procurement prices. In addition to fertilizers, subsidies were provided on canal irrigation, plant protection, power for tubewells etc. Despite sharp increase in public funds for subsldies, high world prices of fertilizers in the years from 1972/73 to 1975 necessitated some upward adjustment in domestic prices of fertilizers. Procurement prices of major crops were increased four times in the five year period from 1972/73 to 1976/77. The frequent enhancement of procurement prices was

justified officially as necessary to maintain incentives to invest in agriculture and to absorb the impact of higher prices of inputs mainly fertilizers.

These policies were reflected in an appreciable improvement in agriculture's terms of trade during the seventies. The index of terms of trade presented in table 3.9. reveals not only a continuation of the positive trend of the sixties but also a sharp acceleration in the rate of change in relative prices in favour of agriculture. Hence while agriculture's terms of trade increase at a rate of less than 1% in the sixties, the trend for the later period was more than double at 2% (Table 3.10).

A. Growth Performance

The incentive strategy which was associated with high rates of agricultural growth in the sixties failed to produce the desired results in the subsequent period.

Agricultural production in the seventies was marked by a sharp deceleration in growth after the consistently high output trend of the previous decade. Total output of major crops increased at an annual rate of 2% for the period from 1969/70 to 1976/77 compared to an annual growth of 6.7% for the earlier years from 1959/60 to 1968/69 (Table 6.1.).

Table 6.1

Trend Rates of Growth of Output of Major Crops and Foodgrains In Pakistan

	1959/60-68/69 Annual Rate		1969/70-76/77 Annual Rate		1959/60-76/77 Annual Rate	
	%	$\bar{R}^2$	%	$\bar{R}^2$	%	$\bar{R}^2$
Total output of Foodgrains	6.7*	.90	2.0**	.26	4.3*	.84
Output per Acre of Major Crope	4.3*	.77	1.5**	.18	3.0*	.79
Total Output of Foodgains	5.0*	.72	3.3*	.77	5.2*	.95
Output per Acre of Foodgrains	2.8**	.38	2.9*	.76	4.2*	.85
Output per Person of Foodgrains	2.3**	.35	.32	.04	2.2*	.70

* Significant at 5% level
** Significant at 10% level

Source: Khan, M.H. Undervelopment and Agrarian Structure, 1981.

Table 6.2

Gross Value of Major Crops In Agriculture (Constant Factor Cost)

	1971/72	1972/73	1973/74	1974/75	1975/76	1976/77
Major crops	8285	8516	8862	8407	8998	9097
Rice	1180	1249	1315	1254	1404	1412
Wheat	2778	3001	3078	2868	3524	3687
Cotton	1893	1878	1762	1682	1363	1132
Sugarcane	1004	1003	1203	1117	1276	1400
Minor Crops	1702	1681	1789	1903	2113	2276

Source: Government of Pakistan, Statistics Division, National Accounts1971-72 to 1974-75.

Aggregate gross value of major crops in constant costs was only 11% higher in 1976/77 than in 1971/72 (Table 6.2). The negligible change in aggregate value added partly reflected the major setback in cotton production which declined throughout the period. Performance of other major crops was far more satisfactory and excluding cotton, gross value for this sector increased by 27% over the same period. As can be seen in table 6.3., although coarse cereals grew at an annual rate of 1.9%, considerably below the overall average, the growth of other major crops was substantially higher. Thus sugarcane registered an annual growth of 3.3% while output of wheat and rice showed a trend of 3.9%. The growth rate in the food sector while relatively higher than the overall trend was nevertheless significantly lower than the trend of 5% in food output achieved in the preceding ten years (Table 6.1). Continued population growth of 3% or more yielded the meagre annual increase in food production per capita of .32%.

The most disappointing aspect of agricultural growth in the seventies was the prevalence of stagnant and declining yields in the case of all crops with the sole exception of wheat. The above average growth recorded for crops like rice and sugarcane were made possible not through an

Table 6.3

Trend Rates of Growth for Production Indices of Major Crops

	1959/60-1969/70		1969/70-1978/79	
	Rate %	$\bar{R}^2$	Rate %	$\bar{R}^2$
Wheat	6.3*	.67	3.9*	.76
Rice	8.0*	.84	3.9*	.77
Maize	4.5*	.71	1.9*	.78
Jowar	2.3	.57	n.s 1.9	.10
Bajra	N.S.	.11	n.s .7	.05
Gram	-2.3*	.36	2.6*	.66
Sugarcane	8.0*	.81	3.3*	.33
Cotton	6.7*	.94	n.s -2.6	.12

Source: Estimating trend equation is logY=a+bt.
Data is taken from Pakistan Economic Survey 1977-78.

Table 6.4

Trend Rates of Output per Acre of Selected Crop

	Wheat		Rice		Cotton		Sugarcane	
	Rate %	$\bar{R}^2$	Rate %	$\bar{R}^2$	Rate %	$\bar{R}^2$	Rate %	$\bar{R}^2$
1959/60 -1968/69	2.5**	.41	3.5*	.71	3.4*	.80	3.5*	.78
1969/70 -1976/77	3.6*	.86	n.s 4.3	.07	-3.5***	.32	n.s -1.5	.22
1959/60 -1976/77	3.9*	.87	4.4:	.87	1.7**	.34	1.1*	.28

** Significan at the 5% level
*** Significant at the 10% level

Source: Khan,M.H. Underdevelopment and Agrarian Structure in Pakistan, 1981.

improvement in yields but through a shift in acreage away from inferior cereals. Only in the case of wheat was improvement in yields a major contributory factor to increase output. Output per acre for wheat grew at an annual rate of 3.5% which was higher than the corresponding figure of 2.5% for the previous decade (Table6.4). The strong positive trend in wheat yields reflected the spread of acreage under hyv seeds. The area covered by the new seed variety which comprised 43% of total wheat agreage in 1969/70 increased to 72% of total wheat acreage and nearly 85% of irrigated wheat acreage by 1976/77 (Table 6.9·).

The expansion in area under new seed varieties of rice lagged behind due to the dominant position of the Basmati a superior variety of rice traditionally grown in the Punjab. Hence while rice acreage under improved seed varieties increased from 57% to 68.7% in Sind the proportion of area covered in the Punjab was only 14.5% in 1976/77 as compared to 11.8% in 1971/72. The substantial growth rate in rice output was the result of greater acreage allocated to the crop. The area under rice increased by 20% between 1971/72 and 1976/77, the largest improvement in area recorded amongst all crops during the period, raising the share of this crop in kharif acreage from 26% to 31% (Table 6.6.). Since overall area under kharif crops did not increase

Table 6.5

Index of Output per Acre of Major Crops

	Foodgrain	Cotton	Sugarcane (Pakistan)	Sugarcane (Punjab)	Sugarcane (Sind)
1959/60	100	100	100	100	100
1960/61	101.3	108.7	111.7	115.7	95.5
1961/62	103.3	108.7	120.3	124.8	96.2
1962/63	105.3	126.1	129.2	132.1	101.8
1963/64	106.3	134.8	125.8	129.6	96.2
1964/65	109.3	121.7	138.1	140.9	100.0
1965/66	98.7	126.1	139.2	142.7	99.3
1966/67	104.6	134.8	126.1	129.9	89.5
1967/68	129.8	134.8	138.1	142.2	96.6
1968/69	135.4	143.5	151.5	161.3	99.3
1969/70	149.0	143.5	158.4	171.5	99.1
1970/71	140.1	147.8	135.7	139.8	99.3
1971/72	150.7	169.6	134.7	139.4	89.7
1972/73	157.6	165.2	139.2	147.8	89.7
1973/74	157.9	169.6	138.1	144.9	90.8
1974/75	163.2	147.8	117.5	123.4	64.1
1975/76	174.2	130.4	136.0	144.6	82.6
1976/77	175.6	108.7	139.5	151.7	82.5

Source: Government of Pakistan, Agriculture Statistics of Pakistan, 1978.

Table 6.6

Trends in Cropped Area 1971/72-1976/77 (million acres)

	1971/72	1972/73	1973/74	1974/75	1975/76	1976/77
Kharif						
Rice	3.60	3.66	3.74	3.96	4.23	4.32
Other Cereals[a]	4.69	4.34	4.83	3.96	4.25	4.25
Cotton	4.84	4.97	4.56	5.02	4.58	4.61
Other Kharif[b]	.65	.53	.59	.60	.69	.67
Total	13.78	13.50	13.72	13.55	13.75	13.75
Rabi						
Wheat	14.33	14.75	15.11	15.11	14.36	15.10
Gram	2.38	2.51	2.74	2.46	2.64	2.71
Rape & Mustard	1.39	1.32	1.32	1.12	1.16	1.28
Othe Rabi[c]	.67	.71	.86	.80	.76	.75
Total	18.77	19.30	20.03	18.74	19.66	20.36
Sugarcane	1.37	1.32	1.60	1.66	1.73	1.95
Farmgate Water Availability (million acre feet)						
Kharif	50.16	56.24	53.94	54.53	55.26	53.42
Rabi	28.04	32.91	34.24	29.40	38.03	40.88

[a] maize, millet, sorghum.

[b] mash, mung, sesamum, groundnuts, onions, garlic, chillies.

[c] barley, masoor, tobacco.

Source: Government of Pakistan, Agriculture Statistics of Pakistan, 1978.

during these years, the greater share of rice was accompanied by a corresponding decline in the share of inferior cereals, mainly jowar and bajra, from 34% to 30% of total area under kharif crops.

Similarly in the case of sugarcane, expansion in area was the main factor contributing to above average rates of production growth. The national average figure for output per acre hides substantial regional variation for the crop. As can be seen from table 6.5, the trend in yield was positive in the Punjab whereas in Sind it was negative. The exceptionally poor performance in the latter province was attributed to rapid expansion in area despite unfavourable soil and water conditions in response to substantial enhancement of procurement price.[1] This expansion in acreage occurred in some areas at the expense of wheat and cotton.

Thus there was a significant change in the sources of increase in output for the period from 1971/72 to 1976/77 as compared to the decade from 1959/60 to 1969/70. In the sixties, especially in the latter half, the combination of hyv seed, fertilizers and increased water availability led to production growth through intensive cultivation rather than through an increase in crop acreage. The output per acre for wheat, rice,

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1 Khan (1981), p. 41.

2 Gotsch (1976., p. 360) as much as 74% of the increase in output in the Third Plan period to the yield effect as compared to only 7% to the area affect.

sugarcane and cotton showed a positive trend varying from 2.5% for wheat to 3.5% for rice and sugarcane (Table 6.4). The most disquieting feature of agricultural growth in the subsequent years was the fact that output increases were largely attributable to shifts in acreage rather than improvements in yields, with the single exception of wheat, despite continued increase in the use of inputs like water and fertilizers.

Data on the supply of irrigation water presented in table 6.7, reveal that the availability of water increased by 24% over the period from 1971/72 to 1976/77. This upward trend was almost entirely due to an increase of 42% in tubewell irrigation raising the share of ground water supplies in total water availability from 21% to 33% during the period. Although the flow of canal water did not display any positive trend, it was marked by considerable fluctuations which had inevitable reprecussions on output. The setback in agriculture in 1974/75 was the result of drought which led to an all time low discharge from canal outlets. Fertilizer offtake which was still much lower than technological potential, doubled during the six year period (Table6.8). Thus although there was a shift from inferior cereals to the major crops, the dramatic improvement in terms of trade and the continued increase in inputs did not induce an increase in overall

Table 6.7

Supply of Irrigation Water in Pakistan (million acre feet)
1965/66-1976/77
Source of Irrigation

	Surface (Canals)	Ground (Tubewells) Public	Ground (Tubewells) Private	Total
1965/66	55	3	7	64
1966/67	58	2	8	68
1967/68	57	2	10	69
1968/69	59	3	11	73
1969/70	60	4	12	76
1970/71	52	4	13	70
1971/72	52	5	15	71
1972/73	61	5	16	81
1973/74	58	5	17	80
1974/75	52	7	18	77
1975/76	59	7	19	85
1976/77	58	8	21	87

Table 6.8

Annual Fertilizer Offtake

	Nitrogen (thousand nutrient metric tons)	Phosphate	NPK (Nutrient in Kilogram per cultivated acre)
1969/70	274	37	6.6
1970/71	252	30	6.1
1971/72	344	37	8.2
1972/73	386	49	9.4
1973/74	342	58	8.5
1974/75	363	60	9.1
1975/76	445	103	11.7
1976/77	511	118	13.1

Source: for table 6.7 and 6.8 : Government of Pakistan, Agricultural Statistics of Pakistan, 1978.

Table 6.9

Use of High Yielding Variety of Wheat and Rice in Pakistan and Provinces

	Percentage share of HYV in Total Acreage of Wheat			Percentage share of HYV in Total Acreage of Rice		
	Pakistan	Punjab	Sind	Pakistan	Punjab	Sind
1968/69	38.4	42.4	35.2	19.8	9.0	36.3
1969/70	43.0	47.0	45.7	30.9	11.8	57.0
1970/71	52.3	53.4	65.2	36.6	13.4	63.1
1971/72	56.7	58.0	67.6	50.0	28.2	75.6
1972/73	56.5	57.8	68.3	43.7	18.4	70.4
1973/74	56.9	58.7	66.9	44.2	17.8	71.6
1974/75	63.3	65.1	80.9	39.3	13.5	69.1
1975/76	65.6	66.7	71.0	38.9	13.2	71.4
1976/77	72.0	74.7	77.3	38.7	14.5	69.7

Source: Government of Pakistan, Agricultural Statistics of Pakistan, 1978.

output through either an increase in area under cultivation or an increase in productivity. The inability to raise the level of productivity in the farm sector despite renumerative prices further underlines the importance of structural impediments to expansion of agricultural production. Under the initial impetus of the tubewell-hyv-fertilizer technology quick easy gains in productivity were possible without any modification of the institutional environment. However while making possible rapid gains in the short run the "green revolution" of the sixties did not set the foundations of sustained growth in the farm sector due to it's limited impact. Firstly the use of new high yielding seed variety was confined to the two major crops of wheat and rice. A similar technological breakthrough had not materialized for other major crops or inferior cereals. Furthermore in the case of rice there was little progress in the spread of area under new varieties in the seventies due to the demand for traditional varieties of the crop. Secondly since supplementary irrigation was an essential prerequisite to the adoption of new seeds technology, its benefits were limited to farms with access to tubewells. In Pakistan where tubewells are concentrated in large farms of 25 acres or more this meant that the benefits of the technological development of the sixties were limited to a small proportion of the farming population.[1]

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[1] For a detailed discussion of this point see Chapter 1 of this thesis.

The sustenance of the momentum of the technological breakthrough required not only qualitative improvement in input use (specially water supply) in conjunction with an effective research and extension program but even more importantly a thoroughgoing reform of the agrarian structure.[1] A more equitable distribution of land resources was an essential condition to a more broad based participation in the productive potential of the new technology. These elements were largely neglected in the Bhutto government strategy which, despite its progressive posture, continued to rely on increasing quantities of inputs and price incentives to achieve the objective of development in the agricultural sector.

Impact of Policies of Mechanization and the Agrarian Structure

Whereas these policies did not raise the level of productivity in the sector they had significant implications on distribution. The improvement in agriculture's terms of trade along with output growth rates of over 3% for major crops transferred income to the net sellers of farm output comprising mainly of large and middle sized farmers.

The surplus was allowed to accumulate in the hands of this group in the continued absence of an effective direct tax

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[1] Some studies on the causes of agricultural stagnation in the seventies have stressed the need for qualitative improvements in water supply through improvement in water channel and drainage works (Gotsch and Brown, 1977; Government of Pakistan, 1978). However the detrimental effect of the highly differentiated agrarian structure on farm productivity has been largely neglected.

on agricultural income. The rate of direct taxes to agricultural income declined markedly over the period falling from an exceptionally low level of 1.0% in 1970/71 to .32% in 1976/77 (See Table 5.11). An income tax on agriculture was announced two months before the March '77 election but the measure was later rejected by the military regime that followed in 1978. The timing of the announcement was an indication of the political importance of the gesture. A tax on agriculture was considered a direct encroachment on the priviledged position of the landed elite. On the one hand with the tremendous symbolic significance of the reform, Bhutto was re-establishing his credentials as the champion of the underpriviledged and above the influence of vested interests. And on the other hand he was providing further incentives for investment in the sector. Generous deductions were allowed on gross income for working capital in the form of seeds, fertilizers, wages, interest etc. Full deductions were also allowed for cost of agricultural machinery such as tractors, tubewells, other farm implements as well as land development and levelling expenses. The various deductions held considerable potential incentives for the modernization of agriculture.

In response to the economic opportunities created by the government policies and the high profitability of capitalist agriculture, the surplus accruing to the landed elite was increasingly channelized into investment in mechanical technology. The share of agriculture in private capital formation which was 13.6% in 1969/70 rose to 19% in 1976/77. (Table 6.31). The rapidly growing component of private capital formation in the sector was investment in machinery and equipment, other than tubewells, comprising mainly of tractors. Thus sub-section accounted for 67% of monetized investment in 1976/77 as compared to the corresponding figure of 44% in 1973/74 (Table 6.10).

Although direct subsidy on tractor purchase was eliminated with the devaluation of the rupee in May 72, private profitability remained high in areas with access to tubewell irrigation. In a study on the economics of mechanization Ahmed[1] has estimated rates of return on tractor use by farms size, based on social accounting prices for factors, prevailing in 1970. His results confirm the expectation of a positive relationship with farm size and show a rate of return as high as 46% for a 50 acre tractor farm with tubewell. For a farm without tubewell the rate falls dramatically to only 3%.

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1 Ahmed (1975) p.59.

Table 6.10

Gross Fixed Capital Formation in Private Agriculture by Type of Assets

million Rs.

Assets	1969/70	1970/71	1971/72	1972/73	1973/74	1974/75	1975/76	1976/77
Total	476.1	463.4	535.2	612.1	737.9	845.7	1348.5	1600.0
Monetized Investment	336.6	321.2	385.9	445.4	558.3	634.7	1100.6	1322.8
Farms, Buildings, Barns and Sheds	8.1	8.2	8.9	9.5	11.8	19.3	28.9	29.8
Transport Equipment	19.1	18.1	21.8	25.2	22.7	25.2	37.2	39.2
Machinery and Other Equipment (Excluding Tubewells)	309.5	294.9	355.2	410.7	248.8	301.3	709.3	883.5
Tubewells					275.0	288.9	324.2	370.3
Non-monetized Investment	139.5	142.2	149.3	166.7	179.6	211.0	247.9	277.2

Source: Government of Pakistan, National Accounts, various issues.

The contribution of tubewells and tractors to net revenue operates through different mechanisms as explained in the study. "Whereas the addition of a tractor increases net revenue through changes in the cropping pattern from low to high value crops, the tubewell achieves it by enabling the bullock farmer to attain a higher cropping intensity."[1] These findings are consistent with the results of other empirical evidence on the subject for Pakistan[2] which reveals no significant positive effect of tractor use on either yields or cropping intensity.

On the other hand available evidence provides considerable support for the negative distributional implications of tractorization through increases in the size of operational holdings, displacement of tenants and unfavourable employment effects. The expectation of an increase in the size of operational holdings with acquisition of a tractor is confirmed by the results of an IBRD survey report.[3] According to the survey 90% of the farms using tractors added to their existing acreage leading to an increase in average farm size from 45 acres to 109 acres, i.e. a change of 142%. The increase was made possible mainly through resumption of land

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1 Ibid., p. 52.

2 Census of Agriculture (1972); McInerney and Donaldson (1975).

3 McInerney and Donaldson (1975).

formerly rented out to tenants and through renting in of land. The former source accounted for 42% of newly acquired land while the contribution of the latter method was 24% of the additional area.

With regard to the employment effects, Ahmed[1] on the basis of a programming model approach predicts an increase in labour demand when tractors are used on tubewell farms. In fact a large proportion of tractors, nearly 72% of the total, are installed in areas with access to tubewell irrigation.[2] However using data from the IBRD survey, Naseem[3] has estimated that the introduction of a tractor lead to the net loss of five permanent jobs. Furthermore nearly 20% of tractors are operating in canal irrigated areas where their employment effect is unambiguously negative.

In the context of the Pakistani rural sector, characterized by highly unequal access to land and the prevalence of surplus labour, the above discussion points to a considerable divergence between the social and private returns to tractor use. However the government saw fit to provide additional incentives for purchase of tractors. Following the devaluation

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1 Ahmed (1975), p. 58.

2 Farm Mechanization Survey 1968.

3 Naseem (1982), p. 103.

of the rupee in '71 tractor imports had slowed down markedly (Table 2.4.). However from 1973 the government encouraged tractor imports mainly through generous provisions of institutional credit at very low interest rates for financing tractor purchases. Agricultural Development Bank loans for tractors increased by four times in the one year period from 1972/73 to 1973/74 (Table 2.3.). As a result tractor imports accelerated sharply and by 1976/77 annual imports had risen to over 15000 compared to imports of less than half that number only two years earlier (Table 2.4.).

Tractor ownership continued to be heavily concentrated in farms of fifty acres or more. Data for 1975[1] shows that nearly 60% of total tractors belonged to this group as compared to 74% in 1968.[2] Ownership of tractors and tubewells was highly corelated: nearly 72% of tractors were purchased by farms with access to supplementary ground water supplies. The combined benefits of hydrological and mechanical technology generated high tax free profits for the large farm sector. Thus while Bhutto's strategy for modernization of agriculture failed to raise the level of productivity in

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1 Government of Pakistan, Farm Mechanization Survey (1975).

2 Government of Pakistan, Farm Mechanization Survey (1968).

the farm sector, it did serve to further strengthen the economic position of the landed elite.

Hence the dualistic development of agriculture set into motion under the impetus of technological change, land reform and the incentive program of the Ayub regime was further perpetuated by the continuation of these policies by Bhutto's government. Since the momentum of the "green revolution" fizzled out considerably in the seventies, the impact of these developments on output was short lived but they triggered off significant changes in the agrarian structure.

The structural changes in operational holdings during the sixties have been analysed in some recent studies[1] based on a comparison of the Agricultural Censuses of 1960 and 1972. The findings of this research show an increase in concentration of land use, reduction of tenancy and a dramatic increase in landlessness over the intercensal period. Resumption of lands from tenants and renting in of land from small owners have been the main factors responsible for the increased skewedness of the distribution of operational holdings.

The land reforms of 1958 which did little to change the

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[1] Hussain (1980); Naseem (1982); Khan (1981).

distribution of land ownership did lead to pre-emptive land transfers and tenant eviction providing the initial stimulus to the process of agrarian change. The tendency towards concentration of land use reflects the ineffectiveness of ceiling legislation in curbing the growing control of the rural elite on land resources. As Naseem has noted: "The fact that the largest size group (i.e. 150 acres or more) of owner cum tenants have gained both in owned and tenanted area very substantially, shows that the power of the "landed aristocracy" has not declined and that by adopting the clever mechanism of transferring land in the names of heirs or fictitious purchasers, which they then rent-in they may be attempting to dodge the land reforms."[1]

Technological change and mechanization have further strengthened the tendency towards larger operational holdings. A large operated area is required to realize maximum profits from the combined effect of tractors, tubewells and new seeds.[2] The importance of this factor in accelerating the process initiated by land reforms is reflected in the fact that the tendencies have been specially marked in the Punjab where the impact of the "green revolution" has been most dramatic. This trend is visible in Khan's provincewise estimates of changes in the number and area of farms by size classes

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1 Naseem (1982), p. 146.

2 Ahmed (1975), p. 59.

between 1960 and 1972 as well as changes in the land tenure patterns for period presented in tables 6.11 and 6.12 respectively. The results indicate that the increase in number and area of large farms, of 50 acres or more, was most impressive in the Punjab. Further analysis by tenurial groups reveals that the declining importance of tenancy was also most pronounced in the Punjab. The number of tenant farms for all size groups declined by 46.6% and their area declined by 26.1% in the Punjab while the corresponding figures for Sind were 2.3% and 12.4% respectively.

The regional variation was even more noticeable in the tendency of renting out of land by marginal and small owners (12 acres or less) accompanied by a growing number of owner-tenants in the largest size group of 50 acres or more. Using data for ownership and operational holdings (1971 and 1972 respectively), Khan[1] has shown that in the Punjab nearly 32% of marginal owners (holdings of less than 6.5 acres) rented out 26% of their land, while in Sind this new type of tenancy was less widespread affecting only 9% of marginal farms and 14% of their area. On the other end of this size spectrum, in the large sized category (50 acres or more), there was a tremendous increase in area

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[1] Khan (1981), p.93.

Table 6.11

Distribution of Operational Holdings in Pakistan and Provinces 1960-1972

Farmsize	Region	Number of Farms (000)			Farm Area (000 acres)		
		1960	1972	%Change	1960	1972	%Change
Under 5 Acres	Pakistan	2404	1059	-55.9	4591	2563	-44.2
	Punjab	1717	619	-63.9	3192	1503	-52.9
	Sind	174	142	-18.4	529	424	-19.8
5 12.5	Pakistan	1340	1501	+12.0	10903	12338	+13.2
	Punjab	894	926	+ 3.6	7281	7619	+ 4.6
	Sind	265	387	+46.0	2180	3261	+49.6
12.5 25.0	Pakistan	729	794	+ 8.9	12533	13061	+ 4.2
	Punjab	488	549	+12.5	326	8942	+ 7.4
	Sind	159	164	+ 3.1	2776	2766	+ 0.4
25 50	Pakistan	286	289	+ 1.0	9468	9215	- 2.7
	Punjab	180	209	+16.1	5903	6608	+11.9
	Sind	61	39	-36.9	2044	1247	-39.0
50 150	Pakistan	88	103	+17.0	6539	7402	+13.2
	Punjab	42	65	+54.8	3087	4569	+48.0
	Sind	18	13	-27.8	1372	1013	-26.2
150 and over	Pakistan	14	16	+14.3	4896	4482	- 8.5
	Punjab	5	7	+40.0	1426	1789	+24.5
	Sind	2	3	+50.0	797	748	- 6.1
All Sizes	Pakistan	4860	3762	-22.6	48930	49061	+ 0.3
	Punjab	3362	2375	-28.6	29214	31030	+ 62.
	Sind	679	748	+10.8	9698	9460	- 2.5

Source: M.H.Khan, Underdevelopment and Agrarian Structure in Pakistan, 1981.

Table 6.12

Change in Distribution of Operational Holdings and Area by Size and Tenure in Pakistan and Provinces - 1960-1972

Percentage Change Between 1960 and 1972

Farm Size	Region	Owner Farms	Owner Tenant Farms	Tenant Farms	Owner Area	Owner Tenant Area	Tenant Area
Marginal (<5)	Pakistan	-46.0	-54.7	-69.3	-28.9	-43.9	-60.7
	Punjab	-54.2	-61.1	-78.1	-38.3	-50.6	-71.8
	Sind	+28.9	+80.0	-35.4	-21.7	+66.7	-34.8
Small (5 < 12.5)	Pakistan	+3.5	+30.0	+1.3	+12.9	+32.7	+3.9
	Punjab	+6.1	+28.1	+14.9	+4.0	+31.5	-12.5
	Sind	+47.7	+144.4	+36.9	+45.9	+139.5	-12.5
Medium (12.5 < 25)	Pakistan	+12.7	+47.9	-12.9	+9.0	+46.1	-19.7
	Punjab	+5.6	+58.3	-11.4	+1.7	+57.5	-19.7
	Sind	+39.3	+52.6	-14.3	+36.4	+50.3	-18.7
Large (25 < 50)	Pakistan	+18.1	+39.4	-34.7	+12.9	+38.5	+39.6
	Punjab	+23.0	+69.6	-23.0	+18.0	+68.1	-29.2
	Sind	0.0	-16.7	-63.6	-6.2	-15.0	-64.6
Very Large (50 and over)	Pakistan	+25.0	+57.7	-39.3	+1.1	+54.8	-41.7
	Punjab	+59.0	+125.0	-16.1	+32.8	+122.3	-25.4
	Sind	-9.1	-7.4	-46.5	-19.0	+1.8	-45.2
All Sizes	Pakistan	-21.5	+7.6	-36.1	+3.6	+37.7	-24.5
	Punjab	-29.1	+9.6	-46.6	+7.0	+53.9	-26.1
	Sind	+29.9	+61.7	-2.3	+3.2	+24.7	-12.4

Source: M.H.Khan, Underdevelopment and Agrarian Structure in Pakistan, 1981.

operated by owner-tenant farms. This area increased by 122.1% in the Punjab while the figure for Sind was only 1.2%.

The growing inequality in the access structure of land resources, through the squeezing out of tenants and small farmers off land, was manifested in the dramatic growth in the incidence of landlessness over the intercensal period. It has been estimated, on the basis of Census data, that the number of landless households increased by 168%, nearly 43% of the increase coming from other sectors of the rural population.[1] Another source places the estimated increase in landless labour households even higher at 384% raising the share of this group to nearly one-third of total rural household.[2]

The tendency towards larger owner operated holdings continued through the seventies under the increased impetus of forces which had produced past changes such as land reforms and further spread of mechanization. Evidence of this trend is provided in Khan's study[3] using data compiled by the provincial Land Reform Commissions for the years 1971 and 1976.

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1 Hussain (1980), p. 183.

2 Naseem (1982), p. 175.

3 Khan (1981), p.92.

Table 6.13

Changes in Self-cultivating Owners and Area in Punjab and Sind Between 1971 and 1976

Farm Size	Percentage of Owners Self Cultivating				Percentage of Area Self Cultivated			
	Punjab		Sind		Punjab		Sind	
	1971	1976	1971	1976	1971	1976	1971	1976
0-6.25	67.4	76.0	91.7	87.1	65.2	72.9	92.9	88.4
>6.25-12.5	67.9	71.4	88.7	84.2	63.7	68.6	90.3	84.7
>12.5-25.0	68.4	61.9	77.0	68.2	61.1	65.1	76.3	67.7
>25.0-50.0	58.3	63.0	52.2	45.8	52.9	61.7	51.0	44.1
>50.0-100.0	43.3	49.6	16.8	13.4	46.0	13.4	16.3	14.3
>100.0-150.0	35.5	39.2	5.8	6.8	33.7	46.0	5.6	6.5
Over 150.0	36.0	37.2	6.0	5.6	37.1	39.6	6.4	5.7
All Sizes	67.0	73.3	76.7	72.8	57.1	64.5	44.4	42.7

Source: M.H.Khan, Underdevelopment and Agrarian Structure in Pakistan, 1981.

His findings reproduced in Table 6.13 show a signicant increase in self cultivating owners and in owned area self cultivated in the Punjab. This is specially marked in the case of large size holdings of 50 acres or more. In the size category of holdings between 50 and 100 acres the percentage of self-cultivating owners increased from 43.3% to 49.6% while percentage of own area self-cultivated increase from 46% to 53% during the five year period from 1971 to 1976. The change was even more dramatic for the larger size class of holdings between 100 and 150 acres in which case proportion of owned area under self-cultivation went up from 33% to 46%. In Sind, however, the practice of parcelling out small areas of land for cultivation by tenants is still dominant in most parts, hence, the distribution of operational holdings is considerably less skewed than ownership of land resources.

Empirical research on the distributional implications of the "green revolution" and the government incentive program points to the expectation of an increase in disparities in the agricultural sector.[1] Although no direct evidence on rural income distribution is available for the seventies, it can safely be deduced, given the continued tendency to concentration of land use, tenant displacement and mechanization that there was no reversal or slowing down of the trend

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[1] Amjad (1972); Alavi (1976); Gotsch (1976); Falcon (1970); Nulty (1972); Kaneda (1969); Khan (1975).

towards the deterioration of the relative position of the poor peasants. That government policies were not designed to curb this trend is reflected in the ineffectiveness of land reforms, further reduction in the ratio of direct taxes to agricultural income and the concentration of public resources in an incentive program whose benefits further buttressed the economic power of the large farmers.

Industrial Sector

The industrial sector during the seventies was characterized by a fall in the rate of growth in output and investment which was unprecedented in the country's economic history. Thus gross domestic product in large scale industry increased by only 7% (Table 6.18) over the six year period from 1970/71 to 1976/77 in sharp contrast to annual average growth of 9% (Table 6.17) in the preceding period from 1963/64 to 1970/71. Private industrial investment fell dramatically. In terms of current prices private investment showed a steep decline from a level of Rs. 1224 million in 1970/71 to Rs. 697 million in 1973/74 (Table 6.15) followed by a recovery in latter years. However there was no reveral in the declining trend of real industrial investment in the private sector (Table 6.16.).

It is generally agreed that the main factor which precipitated the sharp deceleration in investment in industry

Table 6.14

Real Industrial Wages 1951-1975

Fiscal Year	Industrial Wages (Rs. per Year)	Real Industrial Wages (FY 60 Prices)	Index of Real Wages (FY 1961=100)
1951	742	917	93
1961	1142	1080	100
1970	1931	1329	123
1975	4953	1725	160

Source: S.Guisinger and H.Hicks, "Long Term Trends in Income Distribution in Pakistan", World Development, 1978.

Table 6.15

Industrial Investment in Current Prices 1969/70-1976/77 (million rupees)

	Private Industrial Investment			Public Industrial Investment	Total Industrial Investment
	Large and Medium Scale	Small Scale	Total		
1960/70	1208.2	187.7	1395.9	179.2	1575.1
1970/71	1224.0	201.7	1425.7	68.2	1493.9
1971/72	1016.3	219.1	1235.4	98.5	1333.9
1972/73	763.1	255.9	1019.0	110.6	1129.6
1973/74	697.3	325.5	1023.3	382.3	1405.6
1974/75	990.4	446.5	1436.9	1064.9	2501.8
1975/76	1309.0	509.0	1818.5	3181.6	5000.1
1976/77	1209.7	585.3	1795.0	4553.8	6348.8

Source: Government of Pakistan, Finance Division, Economic Survey, 1978.

Table 6.16

Industrial Investment 1970/71 to 1976/77 (million rupees, constant 1969/70 prices)

	Private Sector			Public Sector	Total Industrial Investment
	Large and Medium Scale	Small Scale	Total		
1970/71	1166	192	138	65	1423
1971/72	876	189	1065	85	1150
1972/73	468	157	625	68	693
1973/74	335	157	492	188	680
1974/75	414	187	601	446	1047
1975/76	503	196	700	1224	1924
1976/77	438	213	650	1563	2213

Source: Government of Pakistan, Economic Survey, 1978.

Table 6.17

Real Growth in Industry (annual average percentage rate)

	1963/64-1970/71	1971/72-1976/77	1971/72-1973/74	1974/75-1976/77
Industry	9%	2.9%	8.1%	-0.4%

Source: Growth rate for 1963/64-1970/71 is taken from Guisinger (1977); all the other estimates are based on data from National Accounts, Ministry of Finance, Planning, Development and Provincial Coordination.

was the uncertainty created by the nationalisation of some industries.[1] The nationalisation program of 1972 was limited to ten basic industries including iron and steel, basic metals heavy engineering etc. Liberal compensation was granted for taken over units. The extension of public enterprise into basic industries was not in itself a particular threat to industrialists since most of their assets were concentrated in industries outside this sector. However it was the manner in which it was carried out, accompanied by a flourish of militant rhetoric, which undermined confidence in the business class. Since the pre-election phase the main brunt of Bhutto's radical rhetoric had been directed against the capitalists and had set the basis of a relationship of mutual hostility and distrust.[2] Their suspicions were confirmed with the take over in 1973 of the vegetable ghee industry which was outside the purview of the original nationalisation program. The government assurances of no further nationalisation lost all credibility and the industrialists started moving their assets out of industry at an accelerated pace.

Apart from political uncertainty created by the nationalisation program, there were certain developments.

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1 Sayeed (1981), p. 96; Burki (1980), p. 115.

2 Burki (1980), p. 114.

in the seventies which considerably eroded the rate of return to industrial investment. The domestic terms of trade moved sharply in favour of agriculture between 1972 and 1977. Although relative prices had moved against the industrial sector in the sixties, their negative effect on returns was counteracted by a strict control on the activity of industrial labour and thereby the demand for higher wages and through the use of fiscal, monetary and exchange policies aimed at subsidizing the cost of capital. These policies included the overvaluation of domestic currency, provision of institutional credit at low interest rates, the Bonus Voucher scheme which ensured high returns to manufactured exports and a variety of fiscal concessions such as tax holidays, accelerated depreciation allowances, nominal tariffs on machinery imports etc.

The Bhutto government abolished most of these subsidies beginning with with devaluation of the rupee in May '72 which led to a sharp increase in the cost of machinery and raw materials previously imported at the undervalued official rate. Furthermore the bank rate was raised[1] and the tax holiday system was abolished.[2] The removal of these economic

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[1] Government of Pakistan, Finance Division, Economic Survey 1972/73,p.60.

[2] Government of Pakistan, Finance Division, Budget in Brief, 1972/73,p.36

props left the pampered industrialists with an entirely different and unfavourable configuration of input and output prices.

Furthermore, in the seventies increases in food prices were quickly translated into higher wages in sharp contrast to the situation in the preceding years. Under Ayub's military regime, union activity was kept under tight control considerably limiting the bargaining strength of industrial labour. On the other hand industrial labour was a major constituency of the Peoples Party, therefore under Bhutto's regime there was a marked increase in the power and organisation of this group. The Bhutto government introduced legislation which in addition to ensuring larger benefits to labour with respect to medical coverage, education, insurance etc., also provided a system of automatic adjustment in wages in response to changes in the cost of living index. Three such adjustments took place between 1973, when the latter reform was enacted, and 1975 resulting in an increase in average wage of 88%[1] compared to an increase of 60% in the food price index between 1972/73 and 1974/75 (see Table 6.14). Given the large weight of food in the cost of living index, rising food grain prices were more than compensated by increase in money wages with consequent gains

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1 Guisinger and Hicks (1978), p. 1275.

in the real income of labour at the expense of industrial profits. It has been estimated that labour costs per man (including bonuses and non-wage benefits) tripled for most factories in the large scale manufacturing sector between 1972 and 1977[1] while productivity declined due to strikes and labour unrest.

Relatively higher prices of agricultural commodities not only raised costs indirectly through leading to an increase in wages but also contributed directly to industrial cost as in the case of cotton. The much heralded industrial growth during the sixties had not progressively released the industrial sector from its direct dependence on agriculture. As late as 1970/71, food, tobacco and cotton textiles contributed nearly sixty percent to value added in industry, the share of cotton textiles alone being as high as 30%.[2] Given the high level of dependence, the declining trend in cotton output accompanied by rapidly rising prices was bound to have reprecussions on industrial performance.

The stronger positive trend in the prices of agricultural raw materials as compared to manufactured output is reflected in the declining trend in the ratio of the

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1 World Bank (1978), p. 38.

2 Guisinger (1977), p. 24.

Table 6.18

Gross Domestic Product in Industry 1970/71-1976/77 at Constant Factor Cost of 1959/60

	70/71	71/72	72/73	73/74	74/75	75/76	76/77
Manufacturing	5268	5026	5514	5871	5834	5851	5791
Large-scale	4090	3813	4265	4585	4509	4486	4385
Small-scale	1178	1213	1249	1286	1325	1365	1406

Source:Government of Pakistan, Finance Division, Economic Survey 1978.

Table 6.19

Ratio of Price Indice of Cotton Manufacturing to Raw Cotton (base 1969/70=100)

	Index Numbers of Wholesale Prices of Cotton Manufacture	Index Numbers of Wholesale Prices of Raw Cotton	
	(1)	(2)	(1) - (2)
1969/70	100.00	100.00	100
1970/71	103.59	122.70	84
1971/72	108.10	134.10	81
1972/73	116.43	162.20	72
1973/74	190.00	234.69	81
1974/75	221.39	209.04	105
1975/76	231.83	251.79	92
1976/77	271.48	321.83	84
1977/78	294.57	369.56	80

Source: Government of Pakistan, Central Statistical Office, Statistical Bulletin, 1978.

index of relative prices of manufactures to that of raw cotton. As can be seen from Table 6.19 the index fell from 100 in 1969/70 to a low of 72 in 1972/73 improving somewhat in 1973/74 as a result of a temporary fall in raw cotton prices. However, with the exception of 1974/75, the index stayed at a lower level than had prevailed in the late sixties.

Given the large weight of cotton manufactures in industrial value added, the average growth rate and the considerable variation in industrial output reflected to a large extent the changes in production in this sub-sector. As can be seen in Table 6.17 almost the entire increase in industrial production was concentrated in the early years of the Bhutto government while in the later period beginning in 1974/75 industrial growth was either stagnant or negative. Output indices for selected industrial products presented in Table 6.20 reveal a rapid increase in the production of cotton manufactures in the early seventies attributable to record harvests of cotton crop and favourable demand conditions. The downturn in cotton manufactures although visible earlier in 1973/74 was accelerated in 1974/75 as a result of a severe setback in agricultural output. Between 1974/75 and 1976/77 the output index of cotton yarn fell by 20%

Table 6.20

Indices of Manufacturing Output 1970/71-1976/77 (1969/70=100)

	Manufacturing Total	Selected Items					
		Cotton Yarn	Cotton Cloth	Cement	Cigar-ettes	Fert-ilizers	Veg. Products
1970/71	106.2	111.2	108.5	101.7	108.0	100.0	107.8
1971/72	105.7	122.9	103.6	98.1	97.3	159.7	128.4
1972/73	115.4	137.7	97.0	108.3	123.5	201.1	148.9
1973/74	122.4	138.9	97.6	118.4	122.8	218.2	178.5
1974/75	120.4	128.6	91.7	124.9	119.9	226.8	216.2
1975/76	119.4	128.0	85.8	120.2	122.8	235.4	220.5
1976/77	118.5	104.5	71.6	116.8	126.0	233.7	264.6

Source: Government of Pakistan, Finance Division, Economic Survey, 1978.

Table 6.21

Output Indices for Sugarcane and Raw Cotton (1959/60=100)

	Sugarcane	Raw Cotton
1969/70	248	185
1970/71	218	188
1971/72	179	245
1972/73	189	243
1973/74	226	228
1974/75	201	220
1975/76	240	176
1976/77	276	149

Source: Government of Pakistan, Finance Division, Economic Survey, 1978.

while in the case of cotton textiles, production fell at an annual rate of 8.5% between 1970/71 and 1976/77 (Table 6.21).

The falling trend in output of cotton manufactures which comprised nearly one-third of value-added considerably dampened the rate of industrial growth. As can be seen from Table 6.22, the performance of various other important manufactures was quite in keeping with previous years with growth rates well above the low overall average. Thus the annual growth rate for fertilizers was 8.9% for sugar it was 7.3% while vegetable ghee output increased at an annual rate of 14.7%.

Another factor responsible for the low output growth in manufacturing was the nature of government undertakings in the sector. Public investment in industry had increased sharply from a mere 382 million rupees in 1973/74 to Rs. 3 billion in 1975/76 and Rs. 4.65 billion in 1976/77 (Table 6.15). The share of public investment in total industrial investment went up from 5% to 70% between 1970/71 and 1976/77. However the output response of investment in the public sector was low since the bulk of investment was concentrated in long gestation, capital intensive projects such as the Karachi Steel Mill, which were not expected to contribute to output till the late seventies.[1]

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[1] World Bank (1978), p. 41.

Table 6.22

Growth Rate of Output Indices of Selected Industrial Products
(1969/70=100)

	Cotton Cloth	Sugar	Fertilizers	Vegetable Ghee
1970/71-1978/79	-8.5	7.3	8.9	14.7

Source: Estimating equation is Log Y=a+bt; data is taken from Economic Survey, Government of Pakistan, 1978.

Table 6.23

Investment, Savings, and Foreign Aid Ratios
1960/61-1976/77

(current prices)

	Gross I/GNP	Gross Domestic/GDP Savings	Foreign Gross Aid/Investment
1960/61	16.1	8.5	49.0
1961/62	18.7	10.5	44.0
1962/63	21.7	13.9	36.0
1963/64	20.6	12.9	37.0
1964/65	23.2	12.8	40.0
1965/66	17.7	11.9	33.0
1966/67	17.9	11.8	34.0
1967/68	17.0	11.4	33.0
1968/69	16.8	13.5	20.0
1969/70	15.9	12.7	20.0
1970/71	14.0	8.7	44.0
1971/72	14.2	9.2	34.8
1972/73	12.8	10.1	28.0
1973/74	13.4	6.4	52.1
1974/75	16.2	4.9	69.7
1975/76	17.2	7.9	54.4
1976/77	18.3	7.7	57.9

Source: S.M.Naseem, Poverty and Inequality in Pakistan, 1982.

Balance of Payments

The low levels of production in both agriculture and industry further limited the economy's capacity to earn foreign exchange. Specially damaging to export performance was the slump in the production of raw cotton and the recession in cotton textiles. At the same time the demand for imports increased sharply due to the ambitious public investment program with its heavy requirements of imported capital and intermediate goods, the large increase in foodgrain imports, and the exceptional rise in world prices of major imports such as fertilizers, wheat, oil etc. The trade deficit which was 206 million dollars in 1972/73 increased sevenfold in four years to 1.5 billion dollars (Table 6.27).

The crises in the balance of payments was controlled by the tremendous increase in remittances from expatriate Pakistani workers in the Middle East and a continued increase in foreign assistance not only from the traditional Consortium sources but also from new sources, mainly the OPEC countries. The ratio of foreign assistance to Gross Domestic Product reached a peak in 1974/75, surpassing the levels in the initial years of the Ayub regime (Table 6.23). However the assistance was available on less and less favourable

terms reflected in the considerable reduction of the grant component of aid (Table 6.29).

Domestic Resource Mobilization

The increasing reliance on foreign assistance reflected the most disappointing and damaging aspect of Bhutto's economic policies -- their inability to mobilize domestic resources for development. The saving rate in the economy thus far had not been impressive. In the period of high growth in the sixties, while investment had increased significantly the ratio of savings to GNP had been more or less stagnant at 12% (see Table 6.23) andeven this low figure overstated the actual rate. The procedure of assessing savings as the difference between investment and foreign assistance, the latter being valued at the artificially low official exchange rate, biased upwards the estimate of domestic savings.

The seventies were marked by a further deterioration

in the savings performance. As can be seen from Table 6.23 since 1973/74 the savings rate has been less than 8%, falling as low as 4.9% in 1974/75, a rate which was nearer the mid-fifties level before the planning process had got underway.

The exceptionally low savings for the Bhutto period can be explained firstly by the inability of the state to mobilize the surplus in agriculture, the dominant sector of the economy, either through terms of trade or an effective use of agricultural taxation. Secondly the political constraints on the government prevented squeezing the consumption of the working class in the manner which had been possible under the preceding military regime. Declining returns as a result of higher wages and input costs and most important the fear of nationalization robbed the corporate sector of any incentives to save. Finally the shortfall in private savings could have been counteracted by a serious effort to mobilize public savings. This was not done either through an attempt to enlarge the revenue base or through a curb on non-development spending.

The increase in agriculture's terms of trade as well as comparable growth rates for the output of the two sectors indicate a transfer of income in favour of the farm sector during the seventies. The propensity to save is generally considered to be lower in the rural sector due firstly to the lower per capita income in the sector and secondly due to the supposed tendency in large farmers to direct their surplus into luxury consumption or into real estate.

Unfortunately it is not possible to verify this generalization in the context of the Pakistan economy due to the lack of separate series for income and savings by sectors. However evidence[1] existing for India, a country with a roughly similar economic structure, indicates that the household saving rate in the urban sector is substantially higher than that in the rural sector. The estimates covering the period from 1950 to 1963 not only reveal a much lower saving rate for the rural areas but also show that the difference between the two rates has become greater over time. Thus while rural household savings income ratio was stagnant at around 2.3% during the period, the urban household saving

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[1] Reserve Bank of India Bulletin (1965), p. 327.

rate increased substantially from 7.3% in the initial years to 17% in the early sixties.

Here it can be argued that since the estimates pertain to the period before the technological developments in agriculture they would not be applicable to the later period when the advent of the new technology with its high profitability considerably increased the incentive to save in the sector. However even if there was a dramatic change in the saving behaviour associated with the adoption of the new technology it seems highly unlikely, given that in 1962/63 the rural household saving rate was 2.3% as compared to 17% in the urban sector, that this would reverse the conclusions derived on the intersectoral differential in savings.

Moreover there is no ambiguity on the negative implications on public savings and thereby the overall savings rate of a shift in income through price movements to the group of surplus farmers who are among the most lightly taxed class in the economy. This point will be discussed in greater detail later in this chapter.

The detrimental impact of unfavourable terms of trade on profits and savings in the industrial sector was overshadowed by the even greater disincentive effect of the uncertainty created by the government's nationalization

policies. As has been discussed in greater detail in the preceding section, the Ayub regime had created a specially favourable environment for the industrialists through the use of various policies which ensured a high rate of return to industrial investment. Evidence on the saving behaviour of the corporate sector indicates that during the sixties the sector was retaining over 50% of its profits and if account is taken of tax paid out of profits the saving rate was as high as 80%.[1] Although no information is available on the disposal of corporate profits in the subsequent period, it can safely be deduced that the combination of factors ranging from falling profits and the extreme insecurity among the industrialists, would have considerably reduced the incentive to save and invest in this sector.

The shortfall in private industrial investment was controlled to a large extent by a significant increase in public investment in industry (Table 6.15). However the move towards direct government participation in capital formation was not accompanied by a complementary shift in the strategy for mobilizing public savings.

Under Ayub's government primary reliance had been placed

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1 Amjad (1973).

on the private sector to sustain the level of investment and saving in the economy. The role of government was restricted to creating a favourable environment for private initiative. Fiscal, monetary and exchange policy were all used to attain this objective. Given this strategy the role of public savings was of minor importance. As a result of the policy of encouraging investment through fiscal concessions to the business community and high income groups the ratio of taxes to income rose very slowly over the sixties (Table 5.7).

With the public sector taking over the leading role in the seventies there were far more possibilities for pursuing a more dynamic policy with respect to public savings. However as the data in Table 6.24 shows public savings were negative for most of the period from 1970/71 to 1976/77. Thus while the average tax rate was steady at a level of around 11%, non-development expenditure increased appreciably from 12% in the beginning of the period to nearly 15% in the mid-seventies.

The inadequacy of the public saving effort can be traced to a large extent to the unwillingness of the state to exploit the surplus accruing to the farm sector. The positive trend in agriculture's terms of trade since the late fifties onwards had served to augment the income

Table 6.24

Components of Revenue and Public Expenditure as Percent of GDP

	70/71	71/72	72/73	73/74	74/75	75/76	76/77
Tax Revenue	9.61	10.04	10.97	11.75	10.70	11.14	
Current Revenue	14.2	15.0	14.5	16.0	14.9	15.1	15.4
Non-Development Expenditure	12.4	14.0	13.7	15.1	15.7	14.8	13.6
Development Expenditure	5.5	4.6	5.7	7.4	9.6	10.2	11.2
Foreign Aid	2.5	1.6	5.0	4.5	7.9	7.2	5.4
Expansionary Financing	1.0	2.4	2.3	0.6	1.8	3.0	3.9
Public Savings	0.7	-0.4	-0.5	-0.2	-0.6	-0.7	2.0

Source: Government of Pakistan, Ministry of Finance, Economic Survey, 1978.

Table 6.25

Composition of Non Developmental Expenditures 1970/71-1976/77
(percentage)

	70/71	71/72	72/73	73/74	74/75	75/76	76/77
Defence and Internal Security	48.2	45.8	43.0	37.2	39.7	39.7	42.2
Debt Servicing	14.1	17.4	12.3	14.9	13.7	21.8	19.0
Subsidies	2.7	2.4	8.2	16.5	14.6	8.4	5.1
Education and Health	8.3	7.1	6.8	6.9	7.4	8.1	9.3
General Administration	10.8	8.6	7.7	7.4	6.5	7.0	8.0
	84.0	81.3	78.1	83.0	81.9	85.0	83.6

Source: World Bank (1978).

accruing to surplus farmers. However income originating in the sector which comprised more than one-third of total income in the early seventies was not liable to income taxation. In this context the most urgent reform necessary to widen the fiscal base was to bring the rising farm incomes under the purview of an effective direct tax. Apart from revenue considerations, there was also a strong case for a progressive income tax on agriculture in terms of distributional objectives. It was generally agreed that the advent of the new technology and the incentive policies of the government during the Sixties had conferred disproportionate benefits to the class of large farmers thereby further aggravating the income disparities in the countryside. Evidence on inter-class tax burdens by sectors reveals that it was this upper strata of the rural sector which was greatly undertaxed not only vis a vis their urban counterparts but also relative to the lower income rural classes.

Despite the strong grounds for an effective direct tax of the farm sector, reforms of the agrarian tax structure undertaken by the Bhutto government were limited to minor, cosmetic changes of the existing land revenue system. These changes catered to the demands of both large and small farmers and resulted in the

further erosion of the already miniscule direct tax base. Thus small farmers were exempted from land revenue payments. The replacement of the sliding scale system of assessing revenue with the fixed rate method in the province of Sind made the system more rigid and less responsive to price increases. By 1976/77 only .37% of agricultural income was payed out in direct taxes (Table 5.11).

Moreover the inability to tax agriculture was only part of the fiscal story. The policy of catering to the price demands of surplus farmers as well as protecting the consumption of low income groups was responsible for the rising expenditure on food subsidies which further crippled investible surpluses in the public sector. Thus while procurement prices of wheat were enhanced frequently the selling price was maintained at the previous low level leading to a drain of government resources. The setback in agriculture at a time when world wheat prices were exceptionally high further aggravated the picture and led to tremendous increases in wheat subsidies in the year from 1973 to 1975. The large quantities of wheat imported during the period at high world prices were sold through the public distribution system at very low issue prices. While issue prices had covered between 70-80% of the cost of domestically procured wheat, they barely

Table 6.26

Government Subsidies in Non-Development Expenditure 1970/71-1976/77
(million rupees)

In Non-Development Expenditure	70/71	71/72	72/73	73/74	74/75	75/76	76/77
Wheat	101	125	920	1917	2119	1546	1149
Edible Oil	-	-	-	269	443	-	-
Pakistan Airline	82	83	-	19	115	-	-
Petroleum Products	-	-	-	256	245	248	386
Others	-	-	10	4	51	70	8
Total	183	208	930	2465	2973	1961	1554
In Development Expenditure							
Fertilizer	98	72	228	118	326	607	381
Plant Protection	30	54	128	63	112	241	306
Others	-	1	25	22	16	69	74
Total	128	127	381	203	454	917	761
Total Subsidies	311	335	1311	2668	3427	2878	2315

Source: World Bank (1978).

Table 6.27

Balance of Payments 1972/73-1976/77
(million US dollar)

	1972/73	1973/74	1974/75	1975/76	1976/77
Exports	767	1020	978	1162	1132
Imports	937	1647	2322	2341	2644
Balance of Trade	-206	-627	-1344	-1179	-1512
Workers Remittances	130	138	213	335	578
Current Account Balance	-130	-549	-168	-947	-1052

Source: Government of Pakistan, Finance Division, Economic Survey, 1977/78.

covered 50% of the cost of imported wheat.[1] As a result wheat subsidies increased from 125 million rupees in 1971/72 to over 2 billion rupees in 1974/75.

The scope for public sector savings was further restricted by the substantial increase in non-development spending on other subsections most noticeably on defense and internal security.

Considerable scope also existed for raising the direct tax burden on the non-agricultural sector. The income tax was characterized by a high exemption limit and liberal deductions granted in the form of personal allowances, earned income relief, investment allowances, education allowances, allowances for charitable donations etc. The Taxation Commission '71[2] had strongly recommended removal or reduction of many of these allowances. In its first budget the government announced a curtailment in the allowances for earned income, investment, and charitable donations. These changes were undone soon after to safeguard tax payers from inflation and encourage savings and investment. The exemption limit was doubled from 1973 to 1975 while the investment allowance was enhanced by 50%, personal allowance by 67%, and earned income relief by 200%. Furthermore tax holiday on capital gains and

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1 World Bank (1978), p. 19.

2 Government of Pakistan, Interim Report of the Taxation Commission, 1971, pp. 9-14.

and housing was introduced. The last measure was specially unnecessary since an increasing amount of surplus was being diverted into luxury housing anyway (Table 6.31.). To further encourage this tendency through fiscal concessions was not justified either in terms of distributional objectives or in terms of the productive contribution of investment in the sector. The revenue implications of these changes have been summarized in a recent report as follows: "they have significantly reduced income tax yields by enabling incomes as high as Rs. 35000 or more taking advantage of legitimate deductions to pay little or no taxes at all; they have also prevented the tax base from growing with inflation and income growth, and have actually reduced the number of existing taxpayers since 1973."[1]

The objective of maintaining the consumption of low income groups constrained the growth of indirect taxes. To keep the price increases of essential items under control, excise duties on products like cotton fabrics, kerosene oil etc., were reduced. Similarly the sales tax was affected by exemptions for necessities and capital goods. Although the yield from customs revenue increased

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1 World Bank (1978), p.6.

substantially as a result of the more liberal import policy of the government, the revenue from import duties lagged behind the growth of imports.[1] Once again due to the government's efforts to keep down domestic prices and provide cheap food and inputs a large number of items including wheat, edible oil, fertilizer, crude POL etc., continued to be exempt while machinery and tractors were taxed at less than average rates. In 1971, 6% of imports were exempt from customs duty as compared to nearly 33% in 1976/77.[2]

However despite the limited growth of indirect taxes the period was marked by an increase in their share of total revenue (Table 5.10). The fact that the government chose to rely on this more regressive means of generating revenue exposes the half heartedness of its redistributive claims. A more effective use of the system of direct taxation would not only have been more equitable but it would also have formed the basis of a more elastic and flexible tax structure.[3]

Finally, the surplus potential of public enterprises

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1 World Bank (1978), p.10.

2 Ibid.

3 Empirical research shows that the tax structure of the country is extremely inelastic and inflexible even in comparison with other less developed countries (Jeetun, 1978a,p.31).

failed to materialise. The financial performance of this sector was very poor and they barely contributed 8% from internal sources towards their investment expenditure. Their inability to generate a surplus was attributable to a variety of factors ranging from the overall low level of efficiency to excessive labour costs and underpriced products.[1]

The failure to generate investible resources left the government with no option but to borrow heavily both at home and abroad. The reliance on borrowed funds reached a peak in 1974/75 when 83% of the public development expenditure was financed by foreign assistance while defecit financing covered the remaining outlay (Table 6.30.) Since then there has been some reduction in the proportion of development spending financed by foreign borrowing which fell from a high of 83% in 1974/74 to 70% in 1975/76 and 48% in 1976/77. However the contribution of domestic expansionary financing to the public investment program continued to increase, rising from 17% in 1974/75 to 30% in 1975/76 and nearly 35% in 1976/1977. The value of expansionary financing which was 505 million rupees in 1970/71 had risen to 5.6 billion rupees by 1976/77.

The output increasing impact of the deficit financed

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1 World Bank (1978), p.69.

Table 6.28

Distribution of Foreign Assistance 1972/73-1977/78
(million US dollar)

(Excluding Short Term Credits)

	Consortium	Non Consortium (excluding OPEC)	OPEC sources
1972/73	292.9	48.9	-
1973/74	309.2	23.7	30.0
1974/75	488.3	30.8	410.0
1975/76	527.7	75.9	421.1
1976/77	582.6	49.7	227.8

Source: Government of Pakistan, Finance Division, Economic Survey, 1979/80, p.156.

Table 6.29

Grant and Loan Component of Foreign Aid (percentage)

	Grant	Loan	Total Assistance (million US dollar)
Pre 1st Plan	64%	36%	337
1st Plan (1955-60)	54%	46%	1075
2nd Plan (1960-65)	38%	62%	2910
3rd Plan (1965-70)	24%	76%	2937
1970-71	11%	89%	873
1971-72	43%	57%	143
1972-73	9%	91%	543
1973-74	5%	95%	1268
1974-75	9%	91%	1166
1975-76	11%	89%	922
1976-77	17%	83%	1115

Source: Government of Pakistan Finance Division Economic Survey, 1977/78, p.117

Table 6.30

Financing of Development Expenditures (million rupees)

1970/71 - 1976/77

	70/71	71/72	72/73	73/74	74/75	75/76	76/77
Development Expenditure	2779	2450	3819	6384	10612	13404	16313
Financed by							
Domestic Resources	1025	267	-1045	2020	-209	42	2875
Foreign Assitance	1249	878	3357	3865	8786	9461	7827
Expansionary Financing	505	1305	1507	499	2035	3901	5611

Source: World Bank (1978).

development program was minimal. Public expenditure on irrigation and subsidies in the agricultural sector did not lead to a commensurate increase in farm productivity or cropped agreage. In industry public investment was mainly concentrated in long gestation projects. Of the total resources allocated to the sector nearly 70% were invested in projects, like the Karachi Steel Mill, cement and fertilizer factories which were not expected to yield benefits till the end of the 1970s or, in the case of steel, early eighties.[1]

Inflation

The resulting imbalance between money demand and available output was reflected in an unprecedented rate of inflation in the economy during the period. The general wholesale price index, which had increased by less than 5% annually from 1959/60 to 1971/72,[2] rose by 138% over the next five years with an annual average increase of 28% (Table 6.33.). To a certain extent the rapid rise in prices was due to high prices in world markets transmitted through sharp increases in prices of crucial inputs like oil, food, fertilizers etc. However high rates of inflation persisted in the domestic economy after 1974/75 when the rising trend in world prices had subsided (Table 6.32).

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1 World Bank (1978) p.41.

2 Government of Pakistan, Central Statistical Office (1972), p.314.

A recent empirical study[1] has shown that while the general price level was strongly influenced by international inflationary pressures, more than half the increase in prices during the period could be ascribed to domestic factors.

The inflationary pressure which in the first place was caused by the inability to curtail consumption in the economy had further negative implications for future saving efforts. Firstly, evidence provided in a recent statistical analysis of the relationship between price increases and savings for the period from 1950/51 to 1976/77 points to a significant negative association between inflation and household savings.[2] The strong adverse effect of inflation on household savings was attributed by the author to the negative impact of price increases on the rate of return to financial assets.

Secondly the expectation that inflation would divert investment away from productive sectors to sectors with low social returns was also borne but by Pakistan's experience in the seventies. Data on fixed capital formation by economic sectors presented in Table 6.31 reveal that the proportion of investment in commodity

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1 Pasha (1979), p. 14.

2 Qureishi (1981), pp. 390-391.

Table 6.31

Private Fixed Capital Formation by Economic Sectors 1969/70-1976/77
(million rupees)

	69/70	70/71	71/72	72/73	73/74	74/75	75/76	76/77
Agriculture	476.1	463.4	535.2	612.1	737.9	845.7	1348.5	1506.8
Mining & Quarrying	17.5	18.8	18.0	19.0	22.7	30.2	33.2	36.5
Manufacturing (large Scale)	1208.2	1224.0	1016.3	763.1	697.3	990.4	1309.0	1209.7
Manufacturing (small scale)	187.7	201.7	219.1	255.9	325.5	446.5	509.5	585.3
Construction	61.0	4.4	28.1	23.7	26.7	62.3	49.9	68.5
Electricity and Gas	108.3	107.7	71.3	111.8	0.9	1.0[b]	1.5	4.3
Transport and Communication	514.7	518.3	606.9	968.0	999.6	1016.4	1070.7	1779.0
Financial Institutions and Insurance	51.5	52.0	33.2	34.5	9.8[a]	5.6	8.9	9.1
Ownership of Dwellings	502.3	555.6	603.9	493.8	500.3	1136.4	1341.2	1709.0
Services	366.0	385.5	413.9	444.4	519.3	673.3	813.2	1020.8
Total	3493.3	3531.4	3545.9	3726.3	3840.0	5207.8	6485.6	7950.0

[a] excludes investment in nationalized banks

Source: Government of Pakistan, Economic Survey, 1978.

[b] includes only private share of investment of electricity companies divided on the basis of paid up share capital. The investment in gas companies is also shown under public sector.

producing sectors fell from over 48% in 1969/70 to 34% in 1976/77. The investible surplus was being diverted into services and luxury housing. Investment in ownership of dwellings which accounted for 14% of private capital formation in 1976/77 went up to 25% of private investment by 1976/77.

Finally the price increases put pressure on the balance of payments by their unfavourable effect on exports. The level of inflation in the country was higher than the rate of increase in world prices (Table 6.32) resulting in a deterioration in the competitive position of the country's exports while at the same time making domestic sales more lucrative. This was one of the factors contributing to the stagnation in the country's exports from 1973/74 to 1976/77.[1]

The high rate of price increase was also likely to have adverse distributional consequences. The increase in the food price index was larger than the increase in the general price index. The negative effect of high food prices on income is disproportionately greater on poorer groups due to the larger weight of food expenditure in their budgets. Household data for Pakistan[2] shows that while

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1 World Bank (1978), p. 86.

2 Government of Pakistan, Central Statistical Office, Household Income and Expenditure Survey (1970-71).

Table 6.32

Export and Wholesale Price Indices, 1972/73=100

	1972/73	1973/74	1974/75	1975/76	1976/77
(1) Export Price Index	100	143	146	151	169
(2) Wholesale Price Index	100	127	161	179	195
1 ÷ 2	100	113	90	84	86

Source: World Bank (1978), p.86.

Table 6.33

Index Number of Wholesale Prices (1959/60=100)

	General	Food	Raw Material	Fuel, Lighting & Lubricants	Manufactures
1965/66	112	108.2	125.6	109.2	112.7
1966/67	124.2	126.9	126.2	121.0	117.0
1967/68	126	133.3	106.0	123.6	121.7
1968/69	129.5	134.0	113.2	127.4	129.8
1969/70	132.2	134.1	122.2	132.2	134.3
1970/71	137.3	136.5	133.2	137.1	142.3
1971/72	150.3	153.5	136.3	150.6	151.5
1972/73	179.7	189.1	157.8	182.2	170.8
1973/74	229.1	242.7	205.1	236.0	209.0
1974/75	288.9	302.4	232.1	314.2	284.9
1975/76	321.8	334.4	265.4	370.1	321.8
1976/77	357.1	368.9	312.2	377.2	355.3

Source: Government of Pakistan, Economic Survey, 1978.

food spending comprises nearly 60% of total expenditure of income groups earning less than Rs. 250 per month, its share in the budget of household earnings more than Rs. 1000 is on average much less at 36%.

There are no available estimates on changes in income distribution during the Bhutto period. Information on wages indicates that industrial labour was able to achieve substantial increases in real income. As mentioned earlier the bargaining strength of this group was particularly strong during the Peoples Party rule. However it is difficult to imagine how less organized low income groups could have maintained their economic position in the face of such high rates of inflation and low levels of production.

CONCLUSIONS

The economic policies pursued by both Ayub and Bhutto failed to address the issue central to a development strategy - the problem of mobilizing an investible surplus. In the context of a predominantly agricultural economy like Pakistan any serious effort at the mobilization of domestic resources would necessarily have entailed a significant contribution from the farm sector.

However, evidence for the 1970s presented in in thesis, on changes in the intersectoral terms of trade and in agricultural taxation, the two major instruments historically used to extract a surplus from agriculture, point to a reverse flow of resources into the farm sector.

Thus estimates of the terms of trade for the period refute earlier claims by Gotsch and Brown of a deterioration in the relative price ratio facing the farm sector. The findings of this thesis indicate not only a continuation of the rising trend in agriculture's terms of trade visible in the 1960s but also an acceleration in the rate of increase in favour of the farm sector, especially noticeable in the case of the terms of trade index for intermediate goods.

At the same time, the proportion of agricultural income paid out in direct taxes declined from 1.0% in 1970/71 to .37% in 1976/77. The other side of the picture was the growing regressiveness of the agrarian tax structure. By 1976/77 indirect taxes comprised 95% of the total revenue contribution of the sector as compared to 85% in 1972/73. Estimates of inter-class tax rates by sectors reveal the large differential in tax burdens in favour of the high income groups in the rural sector. Whereas average tax rates for the low income ratio for the two sectors were roughly comparable, the tax income ratio for the high income brackets in the rural sector was less than one-third that of their urban counterparts.

The direction of price and tax policy during the 1970s reflect the continuation of a trend which had been visible from much earlier. Hence the question of extending the income tax to agricultural income was never seriously considered and land revenue remained the only direct tax on the sector. As a result of the inflexibility of the land revenue system and the substantial increases in the productivity of the farm sector the proportion of agricultural income paid out in direct taxes has fallen consistently. Estimates of intersectoral tax burdens for the late 1960s show that the contribution of the agricultural sector to revenue was less than justifiable in terms of the differential in average income of the two sectors.

Although there is no evidence on inter-class tax burdens for the earlier period, the absence of an effective direct tax on agriculture clearly points to a much lower tax burden for the high income groups in the rural areas.

Agriculture's terms of trade, with the exception of the initial years, have shown a positive trend from the mid-1950s onwards despite the dramatic breakthrough in agricultural productivity in the 1960s.

What have been the factors determining the movements in the intersectoral terms of trade? Lewis has explained the changes in the sectoral price ratio in terms of government policies and the changes in the relative scarcity of sectoral outputs. The fall in agriculture's terms of trade in the early 1950s was seen as the result of the trade policy of import control and the overvaluation of domestic currency which raised the price of import substitutes, mostly manufactures, and lowered the prices of exports, which were mainly agricultural commodities. However, the subsequent improvement in the index was attributed to the disparities in the growth of farm and manufacturing outputs. Thus while industrial production increased at rates of over 16% in the fifties, the rate of increase in agricultural production of 1.2% lagged behind the population growth rate. Lewis, however, does not provide any satisfactory

reason for the continued shift in terms of trade in favour of the farm sector in the 1960s despite the substantial increase in agricultural production. His explanation does not refer to the incentive strategy initiated by the Ayub government in 1959 whereby the system of compulsory procurement of foodgrains was replaced by voluntary sales at support prices and the substantial reduction on export duties on agricultural commodities.

Interpretation of changes in the terms of trade during the 1970s emphasize government price policy as the major determinant of changes in the sectoral price ratio. Whereas the Lewis explanation economic policies were motivated by development considerations, in more recent interpretations the influence of Lipton's urban bias is clearly visible. Thus price policy is determined by the political objectives of furthering the economic interests of the groups in power who are representatives of the urban sector. Hence it it claimed, mainly on the basis of the Gotsch and Brown estimates of terms of trade which have been shown to misrepresent the trend for the seventies, that price policy has been motivated by the objective of maintaining artificially low prices of farm products to the benefit of indistrialists and urban consumers.

However, evidence on the intersectoral terms of trade and the contribution of agricultural taxation to revenue goes contrary to the hypothesis that economic policies are designed to serve urban interests. Furthermore, a detailed analysis of government decision on price setting in the 1970s does not show any tendency to maintain low prices of farm output. Information on fertilizer crop ratios, world prices and net returns to various crops, factors which serve as the basis for decisions on price policy, indicate that the enhancement in procurement prices during the period was more than warranted in terms of these considerations alone. Moreover, the tendency to set prices at levels higher than those recommended by economists and planning agencies on the basis of costs and incentives was also noted in the Ayub period.

Similarly, the need to impose an effective direct tax on agriculture has been strongly recommended by various commissions and has been reiterated in every plan document. Yet till 1977 no attempt was taken to implement this major fiscal reform despite the recurring shortfalls in public savings.

Thus the findings point to a bias in price and tax policy, but the bias is clearly not in favour of the urban sector, nor in favour of the rural sector as a whole, but in favour of

the class of large landowners who are the major beneficiaries of high prices and who stand to lose most from a progressive agrarian tax structure.

The state in Pakistan has not been dominated by urban interests but by this class of large farmers whose stronghold in the power structure has survived the various shifts in government. The political power of the landed elite was derived from the extreme concentration of land resources and thereby the control over the peasantry and the rural vote which in a predominantly agrarian society was indispensable to electoral majorities.

Thus in the initial years the representatives of this class completely dominated the Sind and Punjab assemblies as well as various key ministerial posts. The fact that despite the highly skewed distribution of land there was no attempt to enact any ceiling legislation in the first ten years of the country's history is an indication of their considerable influence on public policy.

Ayub's regime, which was prompt in enacting land reform legislation, was viewed by many observers as signifying a restructuring of the power relations in the country. It was

claimed that the locus of power had shifted from the landlords to the monopoly industrialists and middle farmers. However, evidence on the social background of the members of national and provincial assemblies does not reveal any significant reduction in the representation of large landowners in the legislature. The nature of the Ayub land reforms, the failure to tax agricultural income, the primary reliance on an incentive policy in agriculture and government subsidies to tractor imports are further illustration of the undiminished ability of the landlord lobby to influence the direction of economic policy.

Bhutto came into power when the major power blocs were in disarray. The military had suffered a humilating defeat in Bangladesh; the civil service had been the subject of great public criticism; while the largest of the landlords who had traditionally dominated politics were defeated by lesser known candidates of the Peoples Party. At that juncture Bhutto had far more leverage to shift the direction of economic policy than had been possible hitherto.

However, Bhutto had never contemplated a radical reorganisation of the socio-economic structure. As has been pointed out by various observers his socialist platform signified mora a tactical response rather than a genuine ideological commitment. Within the given structure he was fully aware of

the volatile nature of the mass movement he had helped mobilize and was anxious to consolidate his position through establishing alliances with the landed elite. The large landowners of the Punjab who in the pre-election phase had refused Bhutto's attempts to seek their support now eagerly joined the Peoples Party for obviously opportunistic reasons. Thus soon after the elections the landed elite had regained their position as the dominant group in the ruling party.

Unlike the previous regimes Bhutto also had to contend with the demands of the smaller farmers and the poorer strata of the rural sector. That he did not want to lose his image as the champion of the poor was reflected in the symbolic impact of his reforms and the radical flourish with which they were introduced. However, the generous ceilings and various exemptions and loopholes in the land reforms, the continued reliance on an incentive strategy in agriculture, and the growing regressiveness of the agrarian tax structure leave little doubt that the demands of the privileged strata in the countryside were the stronger of the contending pressures.

The link between the dominance of the rural elite and public policy may be critisized as overly simplifying a complex problem and thereby undermining the influence of nationalist aims as well as the conflicting objectives of

other power groups not the least of which were the monopoly industrialists. While this class had few contacts with the Peoples Party, they nevertheless had strong links with the civil-military oligarchy in the sixties. However, on the basis of the strong evidence which extends over a considerable period of time the determining influence of the class of large landowners on the formulation of price and tax policy cannot be denied.

Moreover, although there is a basic conflict of interests over price between surplus farmers and the industrialists the Ayub regime more than compensated the industrialists for the unfavourable trend in sectoral prices by the use of various government measures which greatly subsidized industrial investment while a strict curb on trade union activity kept the increase in wages well under control. It was not the dominant classes, but the less privileged strata in the rural and urban sector who bore the cost of Ayub's economic policies. Thus real wages of industrial workers declined while in the rural sector the position of small farmer and tenants deteriorated vis a vis the large farmers who were the main beneficiaries of the government policies of price incentives and subsidized inputs.

Furthermore, the state had the option of foreign assistance which made it possible to maintain the level of

investment in the economy without recourse to the politically unpleasant task of extracting a surplus from the farm sector. The availability of foreign aid not only made it possible to sustain high rates of investment without a corresponding increase in domestic savings but it also released the economy from the foreign exchange constraint which had brought industrial investment to a standstill in the latter half of the 1950s. The industrial structure which had evolved in the 1950s was dominated by consumer goods and the import quotient of investment was high. Since agricultural exports were the major source of foreign exchange earnings, the stagnation of the agricultural sector in the first decade was eventually reflected in a sharp reduction in foreign exchange resources. Thus the demand for industrial investment in response to high profits was frustrated through an inability to transform rupee savings into capital inputs.

The 1960s were marked by continued rapid industrial growth at an annual rate of over 9%. However, the industrial structure which emerged was a success only in terms of the criteria of high growth. It was not only highly inefficient and capital intensive but also continued to be dominated by consumer goods. Thus by the end of the 1960s nearly 80% of the demand for capital equipment was met by exports.

The fragile base of the aid financed industrial structure was exposed in the initial years of the Third Plan when the curtailment of aid following the 1965 War and two successive bad harvests were accompanied by a sharp drop in investment and savings. As a result of the failure to develop domestic capacity in the capital goods sector and the inability to mobilize domestic savings the industrialisation process continued to be limited by external constraints.

Bhutto assigned high priority to developing a balanced industrial structure and the bulk of the nationalization program was geared to the production of capital goods. However, he did not come to terms with the corresponding problem of raising the rate of domestic saving and once again chose the easier option of relying on foreign aid and defecit financing.

The savings rate since 1973/ has been less than 8 % of GNP, falling as low as 4.5% in 1974/75. The incapacity to accumulate stemmed directly from the political constraints on the government which in some ways were more binding than those of earlier regimes. On the one hand the ruling party was committed to maintaining the consumption levels of the poorer strata including the increasingly organised and powerful

subsector of industrial labour. And on the other hand the importance of the political support of the landed gentry precluded any effort to bring their rising incomes under the purview of an income tax.

Thus no attempt was made to extract the surplus in agriculture either through terms of trade or agricultural taxation. Falling returns as a result of high wages and input costs and even more important uncertainty caused by the nationalisation program dampened the incentive to save and invest in the corporate sector. Finally, the scope for increasing public spending was limited due to the sharp rise in non-development spending, most noticeably on food subsidies and on defence and internal security, and the poor financial performance of the public enterprizes.

Due to the inadequacy of the domestic saving effort the state had to borrow both at home and abroad to finance its ambitious public investment program. The high output response of investment in the sixties had made it possible to finance investment through borrowing without putting too much strain on the economy. The Bhutto period, however, was marked by a dramatic deceleration in the rate of increase of both agricultural and industrial output. Growth rate of output of major crops fell from 6.7% in the decade from 1959/60 to 1968/69 to 2% for the period from 1969/70 to 1976/77. The slowdown in the tempo of manufacturing output was even

more pronounced. Gross domestic product in large scale industry increased by only 7% over the six year period from 1970/71 to 1976/77 in contrast to annual average growth rates of 9% in the preceding period from 1963/64 to 1970/71.

External factors and fortuitous elements such as the oil crises and world recession on the international front and the severe drought in 197/75 on the domestic front certainly contributed to the dismal economic performance during the 1970s.

Furthermore, the eocnomic structure set up under the Ayub regime may have been a success in the short run in terms of rapid output increase but it did not lay the foundation for long run sustained growth. In agriculture the spread of new seeds and tubewells made possible dramatic improvements in productivity without recourse to any institutional reform. However, the imposition of the new technology and the government incentive strategy on the unreformed agrarian structure under-scored the tendency towards dualistic development whereby the modernization process was limited to a small minority of large farmers.

Despite his commitment to a new redistributionist strategy the agricultural policies adopted by Bhutto displayed

a remarkable similarity to those of his predecessor. Thus the land reform stopped far short of any significant redistribution of land resources and primary reliance was placed on incentive through higher prices and subsidised inputs to raise the level of agricultural production. The continuation of these policies perpetuated the adverse impact on the agrarian structure without leading to any improvement in farm productivity. Once the momentum of the bio-chemical technology had subsided, the continued neglect of structural factors and the reliance on an incentive strategy failed to raise the level of overall output. However the incentive policies did result in a signficant increase in output of major crops but this was achieved not through higher yields but through shifts of acreage away from inferior cereals. The surplus accruing to the large farmers as a result of high growth rates in major crops and substantial price increases was diverted into mechanical technology, mainly tractors, with little positive yield effects and further negative implication on rural employment and concentration of land use.

In industry, the rapid manufacturing growth of the preceding decade had not led to a diversified industrial base. Agro-processing industries, like cotton textile and yarn, contributed the bulk of value added in the sector. The failure of cotton output and rising prices of the crop were reflected in the declining trend in the output of cotton manufactures.

Furthermore public investment in industry was concentrated in capital itensive, long gestation projects which were not expected to contribute to output till the late 1970s.

The resulting imbalance between the supply and demand for output was reflected in unprecedented inflationary pressures, worsening of the balance of payments and the diversion of the surplus to non-productive sectors leading to a further erosion of the development process.

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